

# **KENTUCKY RETIREMENT SYSTEMS**

*Kentucky Employees Retirement System  
County Employees Retirement System  
State Police Retirement System*

**Comprehensive Annual Financial Report**  
*For the Fiscal Year Ended June 30, 2003*



*A Component Unit of the  
Commonwealth of Kentucky*

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# KENTUCKY RETIREMENT SYSTEMS

*A Component Unit of the  
Commonwealth of Kentucky*

## **Comprehensive Annual Financial Report** *For the Fiscal Year Ended June 30, 2003*



*KRS Office in Frankfort, Kentucky*

*Prepared by the executive staff of*  
**Kentucky Retirement Systems**

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The cost of printing this CAFR is part of the administrative expense of the system.

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KENTUCKY RETIREMENT SYSTEMS

# **Introductory Section**

*Comprehensive Annual Financial Report*  
June 30, 2003



Kentucky Employees Retirement System  
County Employees Retirement System  
State Police Retirement System

KENTUCKY RETIREMENT SYSTEMS  
Perimeter Park West  
1260 Louisville Road  
Frankfort, Kentucky 40601



William P. Hanes, Esq.  
Executive Director  
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November 20, 2003

The Board of Trustees  
Kentucky Retirement Systems  
Perimeter Park West  
1260 Louisville Road  
Frankfort, KY 40601-6124

Dear Board of Trustees and Members:

I am pleased to present the Comprehensive Annual Financial Report (CAFR) of the Kentucky Employees Retirement System (KERS), County Employees Retirement System (CERS), State Police Retirement System (SPRS) and Insurance Fund for the fiscal year ended June 30, 2003. Responsibility for both the accuracy of the data, and the completeness and fairness of the presentation, rests with the management of the Systems.

The CAFR is divided into six sections:

- An Introductory Section, containing the administrative organization and letter of transmittal.
- A Financial Section, containing the report of the independent Auditor, the financial statements of the three systems and insurance fund and certain required supplementary information.
- An Investment Section, containing a report on investment activity, investment policies, investment results and various investment schedules.
- An Actuarial Section, containing the Actuary's Certification Letter and the results of the annual actuarial valuation.
- A Statistical Section, containing information about plan participants and recipients.
- A Compliance Section, containing a report on compliance and internal control.

We present this information to assist the Board and the members of the retirement systems in understanding the systems' financial and actuarial status. This CAFR was prepared to conform with the principles of governmental accounting and reporting set forth by the Governmental Accounting Standard Board. Transactions of the system are reported on the accrual basis of accounting. Additionally, sufficient internal accounting controls exist to provide reasonable assurance regarding the safekeeping of assets and fair presentation of the financial statements and supporting schedules. Please refer to Management's Discussion and Analysis on page 12 for more information.

### **History**

KERS was created in 1956 by the Kentucky General Assembly in order to supplement the benefits provided by Social Security. When the first actuarial valuation was completed June 30, 1957, there were 16,000 employees participating in KERS and assets of \$2.8 million. SPRS and CERS were established in 1958. The first actuarial valuation of SPRS was conducted June 30, 1959. No actuarial valuation of CERS was conducted until June 30, 1960 because the statutes prohibited retirements from the system prior to July 1, 1960. On June 30, 1960, there were 68 counties and 2,617 employees participating in CERS, and SPRS included 415 uniformed state troopers.

As of June 30, 2003, there were more than 267,000 active and retired members in the three systems and approximately \$12.2 billion in assets. A breakdown of membership by system is provided in the statistical section.

The staff of Kentucky Retirement Systems provides detailed benefit estimates to members upon request. Counselors are available at the Frankfort office for individual counseling, both in office by appointment and by telephone during normal business hours. In addition, staff conducts individual counseling sessions at sites throughout the state and holds preretirement seminars to help members prepare for retirement.

### **Major Initiatives**

As a result of legislation passed during the 2003 General Assembly, KRS began implementing its own personnel system in December 2002. A Human Resources Director was hired to lead the human resources and payroll functions. This position is currently focusing on recruitment, retention and compliance to applicable federal and state statutes. We have already begun to see positive experiences in several operational areas, and we believe the new personnel system will continue to allow Kentucky Retirement Systems to provide even better service to our members.

Additionally, KRS hired an Internal Auditor who is responsible for the planning, implementation and reporting of audits and the internal audit plan. The Internal Auditor is also responsible for the functional control of audit activities in relation to the objectives of the Division of Internal Audit.

### **Certificate of Achievement**

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a certificate of Achievement for Excellence in Financial Reporting to the Kentucky Retirement Systems for its CAFR for the fiscal year ended June 30, 2002. The Certificate of Achievement is a prestigious national award recognizing excellence in the preparation of state and local government financial reports. This was the fourth consecutive year that KRS has achieved this award.

In order to be awarded a Certificate of Achievement, a government unit must publish an easily readable and efficiently organized comprehensive annual financial report. This report must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. We believe that our current comprehensive annual financial report continues to meet the Certificate of Achievement Program's requirements, and we are submitting it to the GFOA to determine its eligibility for another certificate.

### Additions to Plan Net Assets

The collection of employer and employee contributions, as well as income from investments, provide the reserves needed to finance retirement and insurance benefits.

<i>(Dollar amounts expressed in thousands)</i>	<b>2003</b>	<b>2002</b>	<b>Increase (Decrease) Amount</b>	<b>Increase (Decrease) Percentage</b>
<b>Member Contributions</b>	\$314,855	\$286,822	\$28,033	9.7%
<b>Employer Contributions</b>	\$277,012	\$293,520	(\$16,508)	(5.6%)
<b>Net Investment Income</b>	\$464,808	(\$550,490)	\$1,015,298	184.4%
<b>Total</b>	\$1,056,675	\$29,852	\$1,086,527	3639.7%

The increase in member contributions is a reflection of the increase in the covered payroll from the previous year. The corresponding employer contributions decreased by \$16.5 million for a total employer contribution amount of \$277 million. The increase in Net Investment Income is a result of the slightly more favorable financial markets than for fiscal year 2002.

### Deductions To Plan Net Assets

The Kentucky Retirement Systems administers the retirement programs established by the Kentucky General Assembly. The costs associated with those programs include the monthly retirement allowances of retired members under normal, early or disability retirement; payments to beneficiaries; monthly insurance benefits; member refunds and the administrative expenses of the system.

<i>(Dollar amounts expressed in thousands)</i>	<b>2003</b>	<b>2002</b>	<b>Increase (Decrease) Amount</b>	<b>Increase (Decrease) Percentage</b>
<b>Retirement Allowances</b>	\$748,980	\$640,859	\$108,121	16.8%
<b>Refunds</b>	\$20,522	\$ 17,918	\$2,604	14.5%
<b>Administrative Expense</b>	\$15,292	\$ 13,381	\$1,911	14.2%
<b>Medical Insurance Expense</b>	\$113,296	\$ 96,104	\$17,192	17.8%
<b>Total</b>	\$898,090	\$768,262	\$129,828	16.8%

Retirement allowances increased due to a 1.6% cost of living adjustment added to recipients' monthly benefits in July and the increase in the number of retired members. Administrative expenses increased due to equipment purchases, overtime and additional personnel.

### **Investments**

The Board of Trustees of the Kentucky Retirement Systems has a statutory obligation to invest the systems' funds in accordance with the "prudent person rule." The prudent person rule states that fiduciaries shall discharge their investment duties with the same degree of diligence, care and skill that a prudent person would ordinarily exercise under similar circumstances in a comparable position.

The Board has managed the funds in recognition of the basic long-term nature of the systems. The Board has interpreted this to mean that the assets of the three systems should be actively managed — that is, investment decisions regarding the particular securities to be purchased or sold shall be the result of the conscious exercise of discretion. The Board has further recognized that proper diversification of assets must be maintained. The asset allocation can be found in the Investment Section of this CAFR.

The Board's policies have provided significant returns over the long term while minimizing investment related expenses. Due to short-term market conditions for the fiscal year ending June 30, 2003, the systems' pension funds had a total return of 4.3% and the insurance fund had a total return of 1.7%.

### **Funding**

The Kentucky Retirement Systems' funding objective is to meet long-term benefit promises through contributions that remain fairly level as a percent of member payroll. Funding of the pension benefits for all systems as of June 30, 2003 exceeds 97% using the ratio of assets at actuarial value to the total actuarial accrued liability. This funded level will fluctuate over time with experience deviations. Since 1992, all three systems have had a funded level relative to the retirement fund of at least 90% in all valuations.

The medical insurance benefit, created in 1978, is not at the same level of funding. Total insurance liabilities exceed assets in the Insurance Fund by \$4.08 billion. The medical insurance liability continues to be the primary funding concern of the Kentucky Retirement Systems.

A detailed discussion of the funding status of the systems can be found in the Financial Section of this report.

### **Professional Services**

A listing of the Board's contracted consultants can be found in the organizational chart on page 9. A listing of the external investment managers can be found on page 77 in the Investment Section.

### **Other Information**

Kentucky statutes require an annual audit by an independent certified public accountant or the Auditor of Public Accounts. Carpenter, Mountjoy & Bressler PSC performed the audit for the fiscal year ended June 30, 2003, and the results of that audit are contained in the Financial Section. The firm gave the Systems an unqualified opinion and also indicated that the financial statements present fairly, in all material respects, the plan net assets of Kentucky Retirement Systems.

The compilation of this report reflects the combined efforts of Don Mullis, Bob Leggett, Brad Gross and Shawn Sparks under the leadership of the Board of Trustees. It is intended to provide complete and reliable information as a basis for making management decisions, as a means of determining compliance with statutory provisions, and as a means of determining responsible stewardship of the Systems' funds.

The report is available to all employers participating in the Kentucky Retirement Systems. They form the link between the systems and its membership, and their cooperation contributes significantly to the success of the Kentucky Retirement Systems. We hope the employers and their employees find this report informative. This and past CAFRs can be found on the Systems' web site, **[www.kyret.com](http://www.kyret.com)**.

On behalf of the Board of Trustees, I would like to take this opportunity to express my gratitude to the staff, the advisors and the many people who have worked so diligently to assure the successful operation of the Kentucky Retirement Systems.

Respectfully submitted,

A handwritten signature in cursive script, appearing to read "William P. Hanes", is written in black ink. The signature is positioned to the left of a vertical line that extends downwards from the top of the signature area.

William P. Hanes, Esq.  
Executive Director

# Certificate of Achievement for Excellence in Financial Reporting

Presented to

## Kentucky Retirement Systems

For its Comprehensive Annual  
Financial Report  
for the Fiscal Year Ended  
June 30, 2002

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.



President

Executive Director

# Kentucky Retirement Systems Board of Trustees



**John Freeman**  
Louisville  
**Elected by CERS**  
Term expires  
March 31, 2005

**Susan Horne**  
Lexington  
**Elected by KERS**  
Term expires  
March 31, 2006

**Randy Overstreet**  
*Chair*  
**Elected by SPRS**  
Term expires  
March 31, 2007

**Walter Pagan**  
*Vice Chair*  
*Wilder*  
**Appointed by Governor**  
Term expires  
March 31, 2004

**Larry Conner**  
Lexington  
**Appointed by Governor**  
Term expires  
March 31, 2007

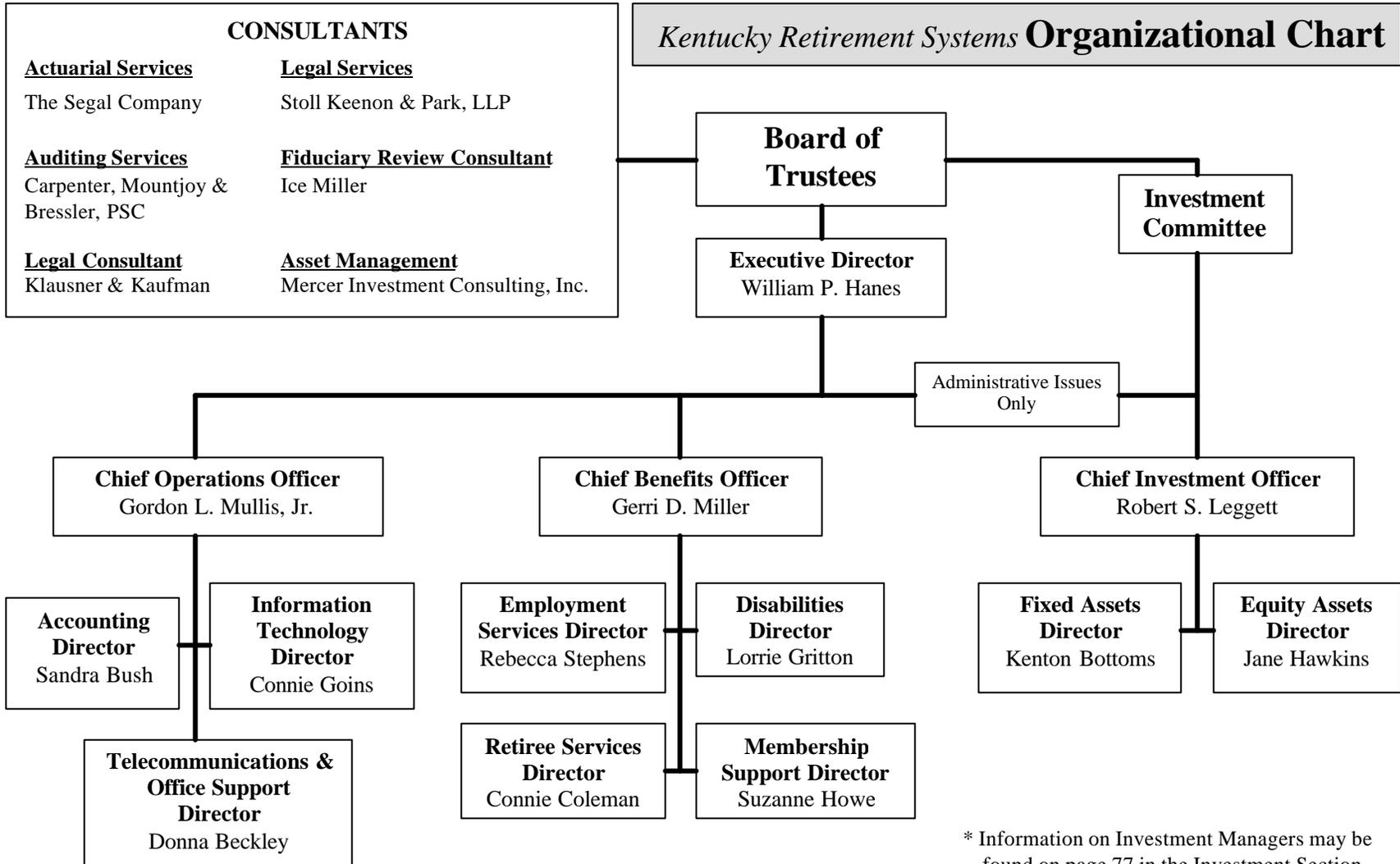
**John Balbach**  
Louisville  
**Appointed by Governor**  
Term expires  
March 31, 2004

**Ed Davis**  
Louisville  
**Elected by CERS**  
Term expires  
March 31, 2005

**Bobby Henson**  
Frankfort  
**Elected by KERS**  
Term expires  
March 31, 2006

**Carol Palmore**  
Frankfort  
**Secretary of Personnel Cabinet**  
Ex Officio

# Kentucky Retirement Systems **Organizational Chart**



\* Information on Investment Managers may be found on page 77 in the Investment Section.

# KENTUCKY RETIREMENT SYSTEMS

## **Financial Section**

*Comprehensive Annual Financial Report*  
June 30, 2003

## INDEPENDENT AUDITOR'S REPORT

Board of Trustees  
Kentucky Retirement Systems  
Frankfort, Kentucky

We have audited the financial statements of the Kentucky Retirement Systems, a component unit of the Commonwealth of Kentucky, as of and for the year ended June 30, 2003, as listed in the table of contents. These financial statements are the responsibility of the Kentucky Retirement Systems' management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of the Kentucky Retirement Systems as of and for the year ended June 30, 2002 were audited by other auditors whose report dated October 31, 2002, expressed an unqualified opinion on those statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the plan net assets of the Kentucky Retirement Systems, a component unit of the Commonwealth of Kentucky, as of June 30, 2003 and the changes in plan net assets for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

In accordance with Government Auditing Standards, we have also issued our report dated September 18, 2003 on our consideration of the Kentucky Retirement Systems' internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be read in conjunction with this report in considering the results of our audit.

Management's Discussion and Analysis (pages 12 through 16) and the supplementary information included in the schedule of funding progress and schedule of employer contributions (pages 45 through 56) are not a required part of the basic financial statements, but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the financial statements taken as a whole. The additional supporting schedules (pages 58 through 61) are presented for the purpose of additional analysis and are not a required part of the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated in all material respects in relation to the financial statements taken as a whole.

September 18, 2003  
Louisville, Kentucky

## **KENTUCKY RETIREMENT SYSTEMS**

# **MANAGEMENT'S DISCUSSION AND ANALYSIS**

*June 30, 2003 and 2002*

This discussion and analysis of Kentucky Retirement Systems' financial performance provides an overview of the pension fund's and insurance fund's financial activities for the fiscal year ended June 30, 2003. Please read it in conjunction with the Pension Fund's financial statements and Insurance Fund's financial statements, which begin on page 17.

### **FINANCIAL HIGHLIGHTS--PENSION FUND**

The following highlights are explained in more detail later in this discussion.

- The combined plan net assets of all pension funds administered by Kentucky Retirement Systems increased by \$5.5 million during the 2002-2003 fiscal year.
- Covered payroll for 2002-2003 was \$4 billion compared to covered payroll for the 2001-2002 plan year of \$3.8 billion, an increase of \$228 million. The corresponding employer contributions decreased by \$16.5 million for a total employer contribution amount of \$277 million. Of the total employer contribution amount, \$43.7 million was posted to the pension fund while \$233.3 million was posted to the insurance fund. Contributions paid by employees were \$314.8 and \$286.8 million respectively for the years ended June 30, 2003 and June 30, 2002. This increase in employee contributions is a reflection of the increase in covered payroll.
- The net appreciation in the fair value of investments was \$110 million for the year ended June 30, 2003 compared to net depreciation of \$868.6 million for the prior fiscal year. Included in this net appreciation were realized losses on sales of investments of \$155.2 million. In comparison, the pension funds realized losses of \$664.3 million for the year ended June 30, 2002. The net realized loss experienced by the pension funds is due to unfavorable market conditions.
- Investment income net of investment expense from all sources including securities lending was \$321 million representing a decline in investment income of approximately \$49.6 million compared to last fiscal year. This decline is due to unfavorable market conditions.
- Pension benefits paid to retirees and beneficiaries increased \$108.1 million bringing total benefit payments to \$749 million. Refund of contributions paid to former members upon termination of employment increased from \$18 million to \$20.5 million.
- Administrative expense increased \$1.8 million totaling \$14.4 million compared to \$12.6 million in the prior year.

### **FINANCIAL HIGHLIGHTS--INSURANCE FUND**

- The following highlights are explained in more detail later in this discussion.
- The combined plan net assets of the insurance fund administered by Kentucky Retirement Systems increased by \$147.4 million during the 2002-2003 fiscal year.
- Employer contributions of \$233.4 million were received. This is a decrease of \$33.9 million over the prior fiscal year. This decrease is due to four of the five systems having a decrease in the insurance transfer percentage rate.
- The net appreciation in the fair value of investments was \$6.3 million compared to depreciation of \$73 million for the prior fiscal year. The insurance fund realized net loss on sale of investments of \$24.8 million. This loss is due to unfavorable market conditions.
- Investment income net of investment expense from all sources including securities lending was \$22 million representing an increase of approximately \$1.8 million compared to last fiscal year.
- Premiums paid by the fund for hospital and medical insurance coverage increased \$17.2 million to total \$113.3 million for the year.

**MANAGEMENT'S DISCUSSION AND ANALYSIS--CONTINUED**  
**June 30, 2003 and 2002**

**USING THIS FINANCIAL REPORT**

Because of the long-term nature of a defined benefit pension plan and post-employment healthcare benefit plan, financial statements alone cannot provide sufficient information to properly reflect the plan's ongoing plan perspective. This financial report consists of two financial statements and two required schedules of historical trend information. The Combined Statements of Plan Net Assets and Combined Statements of Changes in Plan Net Assets (pages 17 and 19) provide information about the activities of the pension funds and insurance fund as a whole. Kentucky Retirement Systems is the fiduciary of funds held in trust for five distinct groups of members. The Combining Statements of Plan Net Assets and Combining Statements of Changes in Plan Net Assets (pages 20 through 25) provide more detailed information about each plan assets, liabilities, plan net assets, and changes in plan net assets.

The Schedule of Funding Progress (pages 45 through 50) includes historical trend information about the actuarially funded status of each plan from a long-term, ongoing plan perspective and the progress made in accumulating sufficient assets to pay benefits and insurance premiums when due. The Schedule of Employer Contributions (pages 51 through 56) presents historical trend information about the annual required contributions of employers and the contributions made by employers in relation to the requirement. These schedules provide information that contributes to understanding the changes over time in the funded status of the plans.

**KENTUCKY RETIREMENT SYSTEMS AS A WHOLE**

Kentucky Retirement Systems' combined plan net assets increased during the year ended June 30, 2003 by \$152.9 million from \$12,104.4 million to \$12,257.3 million. Plan net assets for the prior fiscal year decreased by \$737.3 million. The increase in plan net assets for the plan year ended June 30, 2003 is attributable to the change in market conditions. The analysis below focuses on plan net assets (Table 1) and changes in plan net assets (Table 2) of Kentucky Retirement Systems' pension funds and insurance fund.

**Table 1**  
**Plan Net Assets**  
**(In Millions)**

	Pension Funds			Insurance Fund			Total		
	2003	2002	2001	2003	2002	2001	2003	2002	2001
Cash & Investments	\$14,240.2	\$13,492.8	\$13,420.1	\$1,664.2	\$1,372.5	\$1,156.7	\$15,904.4	\$14,865.3	\$14,576.8
Receivables	124.9	132.0	125.0	25.2	29.6	21.2	150.1	161.6	146.2
Equipment, net of depreciation	1.0	1.2	0.0	0.0	0.0	0.0	1.0	1.2	0.0
<b>Total Assets</b>	<b><u>\$14,366.1</u></b>	<b><u>\$13,626.0</u></b>	<b><u>\$13,545.1</u></b>	<b><u>\$1,689.4</u></b>	<b><u>\$1,402.1</u></b>	<b><u>\$1,177.9</u></b>	<b><u>\$16,055.5</u></b>	<b><u>\$15,028.1</u></b>	<b><u>\$14,723.0</u></b>
<b>Total Liabilities</b>	<b><u>\$(3,452.5)</u></b>	<b><u>\$(2,718.0)</u></b>	<b><u>\$(1,781.9)</u></b>	<b><u>\$(345.7)</u></b>	<b><u>\$(205.7)</u></b>	<b><u>\$(99.4)</u></b>	<b><u>\$(3,798.2)</u></b>	<b><u>\$(2,923.7)</u></b>	<b><u>\$(1,881.3)</u></b>
<b>Plan Net Assets</b>	<b><u>\$10,913.6</u></b>	<b><u>\$10,908.0</u></b>	<b><u>\$11,763.2</u></b>	<b><u>\$1,343.7</u></b>	<b><u>\$1,196.4</u></b>	<b><u>\$1,078.5</u></b>	<b><u>\$12,257.3</u></b>	<b><u>\$12,104.4</u></b>	<b><u>\$12,841.7</u></b>

**MANAGEMENT'S DISCUSSION AND ANALYSIS--CONTINUED**  
**June 30, 2003 and 2002**

**Table 2**  
**Changes in Plan Net Assets**  
(In Millions)

	Pension Funds			Insurance Fund			Total		
	2003	2002	2001	2003	2002	2001	2003	2002	2001
<b>Additions:</b>									
Member Cont.	\$ 314.8	\$ 286.8	\$ 250.2	\$ 0.0	\$ 0.0	\$ 0.0	\$ 314.8	\$ 286.8	\$ 250.2
Employer Cont.	43.7	26.3	105.5	233.4	267.3	182.6	277.1	293.6	288.1
Invest. Inc. (net)	<u>430.9</u>	<u>(498.0)</u>	<u>(698.5)</u>	<u>28.2</u>	<u>(52.5)</u>	<u>(40.7)</u>	<u>459.1</u>	<u>(550.5)</u>	<u>(739.2)</u>
<b>Total additions</b>	<u>\$ 789.4</u>	<u>\$(184.9)</u>	<u>\$(342.8)</u>	<u>\$261.6</u>	<u>\$214.8</u>	<u>\$141.9</u>	<u>\$1,051.0</u>	<u>\$ 29.9</u>	<u>\$(200.9)</u>
<b>Deductions:</b>									
Benefit payments	\$ 749.0	\$ 640.9	\$ 548.5	\$ 0.0	\$ 0.0	\$ 0.0	\$ 749.0	\$ 640.9	\$ 548.5
Refunds	20.5	17.9	18.6	0.0	0.0	0.0	20.5	17.9	18.6
Administrative Expense	14.4	12.6	10.9	0.9	0.8	0.7	15.3	13.4	11.6
Healthcare Premiums	<u>0.0</u>	<u>0.0</u>	<u>0.0</u>	<u>113.3</u>	<u>96.1</u>	<u>81.9</u>	<u>113.3</u>	<u>96.1</u>	<u>81.9</u>
<b>Total deductions</b>	<u>\$ 783.9</u>	<u>\$ 671.4</u>	<u>\$ 578.0</u>	<u>\$114.2</u>	<u>\$ 96.9</u>	<u>\$ 82.6</u>	<u>\$ 898.1</u>	<u>\$ 768.3</u>	<u>\$ 660.6</u>
<b>Increase (decrease) in plan net assets</b>	<u>\$ 5.5</u>	<u>\$(856.3)</u>	<u>\$(920.8)</u>	<u>\$147.4</u>	<u>\$117.9</u>	<u>\$ 59.3</u>	<u>\$ 152.9</u>	<u>\$(738.4)</u>	<u>\$(861.5)</u>

Plan net assets of the pension funds increased by \$5.5 million (\$10,913.6 million compared to \$10,908.0 million). All of these assets are restricted in use to provide monthly retirement allowances to members who contributed to the pension funds as employees and their beneficiaries. This plan net asset increase is attributable primarily to the net appreciation in the fair value of investments due to the change in market conditions in general.

Plan net assets of the insurance fund increased by \$147.4 million (\$1,343.7 million compared to \$1,196.4 million). All of these assets are restricted in use to provide hospital and medical insurance benefits to members of the pension funds who receive a monthly retirement allowance. This increase in net plan assets is primarily attributable to the net appreciation in the fair value of investments which is due to the change in market conditions in general.

### **PENSION FUND ACTIVITIES**

Member contributions increased by \$28 million. Retirement contributions are calculated by applying a percentage factor to salary and are remitted by each employer on behalf of the member. Members may also pay contributions to repurchase previously refunded service credit or to purchase various types of elective service credit. During the year there was an increase in monthly contributions over the previous year due to the increase in salaries reported to Kentucky Retirement Systems. The amount of elective service purchases also increased this fiscal year.

Employer contributions decreased (\$16.5 million). Even though salaries reported to Kentucky Retirement Systems increased (\$228 million), employer contributions decreased due to the reduction in the employer rate applied to covered payroll.

**MANAGEMENT'S DISCUSSION AND ANALYSIS--CONTINUED**  
**June 30, 2003 and 2002**

Net investment income increased by \$928.9 million (income of \$431 million compared to loss of \$498 million in the prior year). The pension funds experienced an increase in income primarily due to the appreciation in the fair value of investments. This can be illustrated as follows:

	<u>In Millions</u>
Appreciation in fair value of investments-June 30, 2003	\$ 477.7
Appreciation in fair value of investments-June 30, 2002	<u>212.5</u>
Net appreciation in fair value of investments	265.2
Investment income (net of investment expense)	321.0
Net loss on sale of investments	<u>(155.2)</u>
Investment income (net)-June 30, 2003	<u>\$ 431.0</u>

Program deductions increased by \$112.6 million caused principally by an increase of \$108.1 million in benefit payments. Retirees received an increase of 2.85% in benefits as of July 1, 2002. Also there was an increase of approximately 1900 members and beneficiaries on the retired payroll as of June 30, 2003. Refunds of member contributions increased by \$2.6 million.

**INSURANCE FUND ACTIVITIES**

Employer contributions paid into the insurance fund decreased by \$33.9 million over the prior year. While covered payroll actually increased by \$228 million, four of the five systems experienced a decrease in rate applied to covered payroll.

Net investment income increased from a net loss of \$52.4 million in the prior year to net income of \$28.2 million this year. This increase in net income is due to the increase in net appreciation in the fair value of assets. This can be illustrated as follows:

	<u>In Millions</u>
Appreciation in fair value of investments-June 30, 2003	\$ 11.2
Appreciation in fair value of investments-June 30, 2002	<u>(19.8)</u>
Net appreciation in fair value of investments	31.0
Investment income (net of investment expense)	22.0
Net loss on sale of investments	<u>(24.8)</u>
Investment Income (net)-June 30, 2003	<u>\$ 28.2</u>

The increase in program deductions is due to the increase in payment of healthcare premiums of \$17.2 million.

**HISTORICAL TRENDS**

Accounting standards require that the statement of plan net assets state asset value at **fair value** and include only benefits and refunds due plan members and beneficiaries and accrued investment and administrative expense as of the reporting date. Information regarding the actuarial funding status of the pension funds and insurance fund is provided in the Schedule of Funding Progress (pages 45 through 50). The asset value stated in the Schedule of Funding Progress is the **actuarial value** of assets determined by calculating the difference between the expected valuation assets and the actual market value of assets adjusted for any unrecognized gains or losses and amortized over a five year period. The actuarial accrued liability is calculated using the entry age normal cost funding method.

**MANAGEMENT'S DISCUSSION AND ANALYSIS--CONTINUED**  
**June 30, 2003 and 2002**

The funding position of the pension funds continues to provide more than adequate assets to meet pension obligations. The insurance fund continues to have a large unfunded liability of all participating employees groups. However, the funded ratio for all employee groups participating in the pension funds and the insurance fund show a positive trend over the six-year period displayed.

Annual required contributions of the employers and contributions made by the employers in relation to the required contributions are provided in the Schedule of Employer Contributions (pages 51 through 56). This schedule indicates that employers are generally meeting their responsibilities to provide resources to the plans.

**KENTUCKY RETIREMENT SYSTEMS**  
**COMBINED STATEMENTS OF PLAN NET ASSETS**  
**June 30, 2003 and 2002**  
(Dollars in Thousands)

<b>ASSETS</b>	2003			2002		
	Pension	Post- Employment Healthcare	Total	Pension (Restated)	Post- Employment Healthcare	Total (Restated)
<b>Cash and Short-Term Investments</b>						
Cash	\$ 1,493	\$ 216	\$ 1,709	\$ 28,494	\$ 24,939	\$ 53,433
Short-term investments	<u>485,752</u>	<u>147,010</u>	<u>632,762</u>	<u>548,058</u>	<u>142,009</u>	<u>690,067</u>
<b>Total cash and short-term investments</b>	487,245	147,226	634,471	576,552	166,948	743,500
<b>Receivables</b>						
Investments - accounts receivable	480	63	543	720	70	790
Interest receivable - year end	59,102	3,371	62,473	70,486	3,027	73,513
Accounts receivable - year end	62,139	21,790	83,929	57,008	26,494	83,502
Accounts receivable - alternate plan	2,970	-	2,970	3,551	-	3,551
Accounts receivable - alternate plan - year end	<u>187</u>	<u>-</u>	<u>187</u>	<u>244</u>	<u>-</u>	<u>244</u>
<b>Total receivables</b>	124,878	25,224	150,102	132,009	29,591	161,600
<b>Investments, at fair value</b>						
Corporate and government bonds	3,845,290	133,241	3,978,531	3,680,675	119,766	3,800,441
Corporate stocks	5,886,202	1,039,366	6,925,568	5,861,831	881,263	6,743,094
Mortgages	560,005	-	560,005	642,520	-	642,520
Real estate	<u>17,256</u>	<u>-</u>	<u>17,256</u>	<u>21,699</u>	<u>-</u>	<u>21,699</u>
<b>Total investments</b>	10,308,753	1,172,607	11,481,360	10,206,725	1,001,029	11,207,754
<b>Securities lending collateral invested</b>	3,444,164	344,416	3,788,580	2,709,530	204,493	2,914,023
<b>Equipment (net of accumulated depreciation)</b>	<u>1,012</u>	<u>-</u>	<u>1,012</u>	<u>1,199</u>	<u>-</u>	<u>1,199</u>
<b>Total Assets</b>	<u>14,366,052</u>	<u>1,689,473</u>	<u>16,055,525</u>	<u>13,626,015</u>	<u>1,402,061</u>	<u>15,028,076</u>
<b>LIABILITIES</b>						
Accounts payable	8,340	1,258	9,598	8,446	1,193	9,639
Securities lending collateral obligations	<u>3,444,164</u>	<u>344,416</u>	<u>3,788,580</u>	<u>2,709,530</u>	<u>204,493</u>	<u>2,914,023</u>
<b>Total Liabilities</b>	<u>3,452,504</u>	<u>345,674</u>	<u>3,798,178</u>	<u>2,717,976</u>	<u>205,686</u>	<u>2,923,662</u>
<b>Plan Net Assets Held in Trust for Plan Benefits</b>	<u>\$ 10,913,548</u>	<u>\$ 1,343,799</u>	<u>\$ 12,257,347</u>	<u>\$ 10,908,039</u>	<u>\$ 1,196,375</u>	<u>\$ 12,104,414</u>

(A schedule of funding progress for each plan is presented on pages 45-50)

See accompanying independent auditor's report and notes to financial statements.

**KENTUCKY RETIREMENT SYSTEMS**  
**COMBINED STATEMENTS OF CHANGES IN PLAN NET ASSETS**  
**Years Ended June 30, 2003 and 2002**  
(Dollars in Thousands)

	2003			2002		
	Pension	Post- Employment Healthcare	Total	Pension (Restated)	Post- Employment Healthcare	Total (Restated)
<b>ADDITIONS</b>						
Members' contributions	\$ 314,855	\$ -	\$ 314,855	\$ 286,822	\$ -	\$ 286,822
Employers' contributions	43,661	233,351	277,012	26,260	267,260	293,520
<b>Total contributions</b>	358,516	233,351	591,867	313,082	267,260	580,342
<b>Investment Income</b>						
From investing activities						
Net appreciation (depreciation) in fair value of investments	109,972	6,272	116,244	(868,579)	(134,227)	(1,002,806)
Demutualization proceeds	-	-	-	-	61,603	61,603
Interest	228,942	7,141	236,083	240,540	13,147	253,687
Dividends	97,317	15,164	112,481	130,801	7,149	137,950
<b>Total investing activities income (loss)</b>	436,231	28,577	464,808	(497,238)	(52,328)	(549,566)
<b>Investment expense</b>	7,385	522	7,907	7,295	451	7,746
<b>Commissions</b>	3,101	378	3,479	3,990	430	4,420
<b>Total investing activities expense</b>	10,486	900	11,386	11,285	881	12,166
<b>Net income (loss) from investing activities</b>	425,745	27,677	453,422	(508,523)	(53,209)	(561,732)
<b>From Securities Lending Activities</b>						
Securities lending income	35,925	2,980	38,905	60,496	4,242	64,738
Securities lending expense:						
Security borrower rebate	29,191	2,286	31,477	47,021	3,325	50,346
Security lending agent fee	1,554	140	1,694	2,964	186	3,150
<b>Net income from securities lending activities</b>	5,180	554	5,734	10,511	731	11,242
<b>Total net investment income (loss)</b>	430,925	28,231	459,156	(498,012)	(52,478)	(550,490)
<b>Total Additions</b>	789,441	261,582	1,051,023	(184,930)	214,782	29,852

	2003			2002		
	Pension	Post-Employment Healthcare	Total	Pension (Restated)	Post-Employment Healthcare	Total (Restated)
<b>DEDUCTIONS</b>						
Benefit payments	\$ 748,980	\$ -	\$ 748,980	\$ 640,859	\$ -	\$ 640,859
Refunds	20,522	-	20,522	17,918	-	17,918
Administrative expenses	14,430	862	15,292	12,603	778	13,381
Healthcare premiums paid	-	113,296	113,296	-	96,104	96,104
<b>Total deductions</b>	<u>783,932</u>	<u>114,158</u>	<u>898,090</u>	<u>671,380</u>	<u>96,882</u>	<u>768,262</u>
<b>Net increase (decrease) in plan assets</b>	5,509	147,424	152,933	(856,310)	117,900	(738,410)
<b>Plan Net Assets Held in Trust for Plan Benefits</b>						
<b>Beginning of Year (as previously reported for 2002)</b>	10,908,039	1,196,375	12,104,414	11,763,201	1,078,475	12,841,676
<b>Adjustment for Change in Accounting Method</b>	-	-	-	1,148	-	1,148
<b>Beginning of Year (as restated for 2002)</b>	<u>10,908,039</u>	<u>1,196,375</u>	<u>12,104,414</u>	<u>11,764,349</u>	<u>1,078,475</u>	<u>12,842,824</u>
<b>End of Year (as restated for 2002)</b>	<u>\$ 10,913,548</u>	<u>\$ 1,343,799</u>	<u>\$ 12,257,347</u>	<u>\$ 10,908,039</u>	<u>\$ 1,196,375</u>	<u>\$ 12,104,414</u>

See accompanying independent auditor's report and notes to financial statements.

**KENTUCKY RETIREMENT SYSTEMS**  
**COMBINING STATEMENTS OF PLAN NET ASSETS--PENSION FUNDS**  
**June 30, 2003 and 2002**  
(Dollars in Thousands)

<b>ASSETS</b>	<u>KERS</u> <u>Hazardous</u>	<u>KERS</u> <u>Non-Hazardous</u>	<u>CERS</u> <u>Hazardous</u>	<u>CERS</u> <u>Non-Hazardous</u>	<u>State</u> <u>Police</u>	<u>2003</u> <u>Total</u>	<u>2002 Total</u> <u>(Restated)</u>
<b>Cash and short-term investments</b>							
Cash	\$ 139	\$ 386	\$ 218	\$ 615	\$ 135	\$ 1,493	\$ 28,494
Short-term investments	<u>18,057</u>	<u>152,861</u>	<u>68,395</u>	<u>238,154</u>	<u>8,285</u>	<u>485,752</u>	<u>548,058</u>
<b>Total cash and short-term investments</b>	18,196	153,247	68,613	238,769	8,420	487,245	576,552
<b>Receivables</b>							
Investments - accounts receivable	16	165	64	225	10	480	720
Interest receivable - year end	1,642	27,079	6,180	22,424	1,777	59,102	70,486
Accounts receivable - year end	3,036	28,459	8,194	21,426	1,024	62,139	57,008
Accounts receivable - alternate plan	-	-	1,673	1,297	-	2,970	3,551
Accounts receivable-alternate plan-year end	<u>-</u>	<u>-</u>	<u>122</u>	<u>65</u>	<u>-</u>	<u>187</u>	<u>244</u>
<b>Total receivables</b>	4,694	55,703	16,233	45,437	2,811	124,878	132,009
<b>Investments, at fair value</b>							
Corporate and government bonds	104,852	1,772,037	398,907	1,452,706	116,788	3,845,290	3,680,675
Corporate stocks	175,804	2,686,554	624,404	2,226,016	173,424	5,886,202	5,861,831
Mortgages	15,234	257,881	58,421	211,499	16,970	560,005	642,520
Real estate	<u>1,994</u>	<u>6,641</u>	<u>3,055</u>	<u>4,742</u>	<u>824</u>	<u>17,256</u>	<u>21,699</u>
<b>Total investments at fair value</b>	297,884	4,723,113	1,084,787	3,894,963	308,006	10,308,753	10,206,725
<b>Securities lending collateral invested</b>	100,809	1,555,789	367,918	1,318,687	100,961	3,444,164	2,709,530
<b>Equipment (net of accumulated depreciation)</b>	<u>28</u>	<u>348</u>	<u>52</u>	<u>578</u>	<u>6</u>	<u>1,012</u>	<u>1,199</u>
<b>Total Assets</b>	<u>421,611</u>	<u>6,488,200</u>	<u>1,537,603</u>	<u>5,498,434</u>	<u>420,204</u>	<u>14,366,052</u>	<u>13,626,015</u>
<b>LIABILITIES</b>							
Accounts payable	289	3,092	909	3,922	128	8,340	8,446
Securities lending collateral	<u>100,809</u>	<u>1,555,789</u>	<u>367,918</u>	<u>1,318,687</u>	<u>100,961</u>	<u>3,444,164</u>	<u>2,709,530</u>
<b>Total Liabilities</b>	<u>101,098</u>	<u>1,558,881</u>	<u>368,827</u>	<u>1,322,609</u>	<u>101,089</u>	<u>3,452,504</u>	<u>2,717,976</u>
<b>Plan Net Assets Held in Trust for Pension Benefits</b>	<u>\$ 320,513</u>	<u>\$ 4,929,319</u>	<u>\$ 1,168,776</u>	<u>\$ 4,175,825</u>	<u>\$ 319,115</u>	<u>\$ 10,913,548</u>	<u>\$ 10,908,039</u>

(A schedule of funding progress for each plan is presented on pages 45-50)

See accompanying independent auditor's report and notes to financial statements.

**KENTUCKY RETIREMENT SYSTEMS**  
**COMBINING STATEMENTS OF CHANGES IN PLAN NET ASSETS--PENSION FUNDS**  
**Years Ended June 30, 2003 and 2002**  
(Dollars in Thousands)

	<u>KERS</u> <u>Hazardous</u>	<u>KERS</u> <u>Non-Hazardous</u>	<u>CERS</u> <u>Hazardous</u>	<u>CERS</u> <u>Non-Hazardous</u>	<u>State</u> <u>Police</u>	<u>2003</u> <u>Total</u>	<u>2002 Total</u> <u>(Restated)</u>
<b>ADDITIONS</b>							
Members' contributions	\$ 11,553	\$ 137,124	\$ 36,203	\$ 125,301	\$ 4,674	\$ 314,855	\$ 286,822
Employers' contributions	<u>7,322</u>	<u>7,597</u>	<u>16,906</u>	<u>11,856</u>	<u>(20)</u>	<u>43,661</u>	<u>26,260</u>
<b>Total contributions</b>	18,875	144,721	53,109	137,157	4,654	358,516	313,082
<b>INVESTMENT INCOME</b>							
From investing activities							
Net appreciation (depreciation) in fair value of investments	5,566	50,102	12,185	38,004	4,115	109,972	(868,579)
Interest	6,494	104,393	24,204	86,970	6,881	228,942	240,540
Dividends	<u>2,760</u>	<u>44,374</u>	<u>10,289</u>	<u>36,969</u>	<u>2,925</u>	<u>97,317</u>	<u>130,801</u>
<b>Total investing activities income (loss)</b>	14,820	198,869	46,678	161,943	13,921	436,231	(497,238)
<b>Investment expense</b>	217	3,313	790	2,851	214	7,385	7,295
<b>Commissions</b>	<u>91</u>	<u>1,401</u>	<u>331</u>	<u>1,187</u>	<u>91</u>	<u>3,101</u>	<u>3,990</u>
<b>Total investing activities expense</b>	<u>308</u>	<u>4,714</u>	<u>1,121</u>	<u>4,038</u>	<u>305</u>	<u>10,486</u>	<u>11,285</u>
<b>Net income from investing activities</b>	<u>14,512</u>	<u>194,155</u>	<u>45,557</u>	<u>157,905</u>	<u>13,616</u>	<u>425,745</u>	<u>(508,523)</u>
<b>From Securities Lending Activities</b>							
Securities lending income	1,577	13,621	4,504	15,295	928	35,925	60,496
Securities lending expense:							
Security borrower rebates	1,279	11,080	3,655	12,428	749	29,191	47,021
Security lending agent fees	<u>68</u>	<u>590</u>	<u>194</u>	<u>662</u>	<u>40</u>	<u>1,554</u>	<u>2,964</u>
<b>Net income from securities lending activities</b>	<u>230</u>	<u>1,951</u>	<u>655</u>	<u>2,205</u>	<u>139</u>	<u>5,180</u>	<u>10,511</u>
<b>Total net investment income</b>	<u>14,742</u>	<u>196,106</u>	<u>46,212</u>	<u>160,110</u>	<u>13,755</u>	<u>430,925</u>	<u>(498,012)</u>
<b>Total Additions</b>	33,617	340,827	99,321	297,267	18,409	789,441	(184,930)

	<u>KERS</u> <u>Hazardous</u>	<u>KERS</u> <u>Non-Hazardous</u>	<u>CERS</u> <u>Hazardous</u>	<u>CERS</u> <u>Non-Hazardous</u>	<u>State</u> <u>Police</u>	<u>2003</u> <u>Total</u>	<u>2002 Total</u> <u>(Restated)</u>
<b>DEDUCTIONS</b>							
Benefit payments	\$ 13,373	\$ 404,896	\$ 72,532	\$ 230,317	\$ 27,862	\$ 748,980	\$ 640,859
Refunds	1,160	7,258	1,794	10,213	97	20,522	17,918
Administrative expenses	<u>404</u>	<u>4,959</u>	<u>737</u>	<u>8,244</u>	<u>86</u>	<u>14,430</u>	<u>12,603</u>
<b>Total deductions</b>	<u>14,937</u>	<u>417,113</u>	<u>75,063</u>	<u>248,774</u>	<u>28,045</u>	<u>783,932</u>	<u>671,380</u>
<b>Net increase (decrease) in plan assets</b>	18,680	(76,286)	24,258	48,493	(9,636)	5,509	(856,310)
<b>Plan net assets held in trust for Pension Benefits</b>							
<b>Beginning of Year (as previously reported for 2002)</b>	301,833	5,005,605	1,144,518	4,127,332	328,751	10,908,039	11,763,201
<b>Adjustment for Change in Accounting Method</b>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>1,148</u>
<b>Beginning of Year (as restated for 2002)</b>	<u>301,833</u>	<u>5,005,605</u>	<u>1,144,518</u>	<u>4,127,332</u>	<u>328,751</u>	<u>10,908,039</u>	<u>11,764,349</u>
<b>End of Year (as restated for 2002)</b>	<u>\$ 320,513</u>	<u>\$ 4,929,319</u>	<u>\$ 1,168,776</u>	<u>\$ 4,175,825</u>	<u>\$ 319,115</u>	<u>\$ 10,913,548</u>	<u>\$ 10,908,039</u>

See accompanying independent auditor's report and notes to financial statements.

**KENTUCKY RETIREMENT SYSTEMS**  
**COMBINING STATEMENTS OF PLAN NET ASSETS--POST-EMPLOYMENT HEALTHCARE**  
**June 30, 2003 and 2002**  
(Dollars in Thousands)

<b>ASSETS</b>	<u>KERS</u> <u>Hazardous</u>	<u>KERS</u> <u>Non-Hazardous</u>	<u>CERS</u> <u>Hazardous</u>	<u>CERS</u> <u>Non-Hazardous</u>	<u>State</u> <u>Police</u>	<u>2003</u> <u>Total</u>	<u>2002</u> <u>Total</u>
<b>Cash and short-term investments</b>							
Cash	\$ 25	\$ 31	\$ 82	\$ 64	\$ 14	\$ 216	\$ 24,940
Short-term investments	<u>8,203</u>	<u>89,312</u>	<u>15,308</u>	<u>29,905</u>	<u>4,282</u>	<u>147,010</u>	<u>142,008</u>
<b>Total cash and short-term investments</b>	8,228	89,343	15,390	29,969	4,296	147,226	166,948
<b>Receivables</b>							
Investments - accounts receivable	6	21	12	22	2	63	70
Interest receivable - year end	328	1,180	560	1,104	199	3,371	3,027
Accounts receivable - year end	<u>1,334</u>	<u>5,457</u>	<u>3,653</u>	<u>10,695</u>	<u>651</u>	<u>21,790</u>	<u>26,494</u>
<b>Total receivables</b>	1,668	6,658	4,225	11,821	852	25,224	29,591
<b>Investments, at fair value</b>							
Corporate and government bonds	12,871	48,016	21,287	42,820	8,247	133,241	119,766
Corporate stocks	<u>102,823</u>	<u>343,727</u>	<u>182,396</u>	<u>351,228</u>	<u>59,192</u>	<u>1,039,366</u>	<u>881,263</u>
<b>Total investments</b>	115,694	391,743	203,683	394,048	67,439	1,172,607	1,001,029
<b>Security lending collateral invested</b>	<u>31,894</u>	<u>134,627</u>	<u>53,881</u>	<u>104,216</u>	<u>19,798</u>	<u>344,416</u>	<u>204,493</u>
<b>Total Assets</b>	<u>157,484</u>	<u>622,371</u>	<u>277,179</u>	<u>540,054</u>	<u>92,385</u>	<u>1,689,473</u>	<u>1,402,061</u>
<b>LIABILITIES</b>							
Accounts payable	68	673	130	338	49	1,258	1,193
Securities lending collateral obligations	<u>31,894</u>	<u>134,627</u>	<u>53,881</u>	<u>104,216</u>	<u>19,798</u>	<u>344,416</u>	<u>204,493</u>
<b>Total Liabilities</b>	<u>31,962</u>	<u>135,300</u>	<u>54,011</u>	<u>104,554</u>	<u>19,847</u>	<u>345,674</u>	<u>205,686</u>
<b>Plan Net Assets Held in Trust for Post-Employment Healthcare Benefits</b>	<u>\$ 125,522</u>	<u>\$ 487,071</u>	<u>\$ 223,168</u>	<u>\$ 435,500</u>	<u>\$ 72,538</u>	<u>\$ 1,343,799</u>	<u>\$ 1,196,375</u>

(A schedule of funding progress for each plan is presented on pages 45-50)

See accompanying independent auditor's report and notes to financial statements.

**KENTUCKY RETIREMENT SYSTEMS**  
**COMBINING STATEMENTS OF CHANGES IN PLAN NET ASSETS--POST-EMPLOYMENT HEALTHCARE**  
**Years Ended June 30, 2003 and 2002**  
(Dollars in Thousands)

	<u>KERS</u> <u>Hazardous</u>	<u>KERS</u> <u>Non-Hazardous</u>	<u>CERS</u> <u>Hazardous</u>	<u>CERS</u> <u>Non-Hazardous</u>	<u>State</u> <u>Police</u>	<u>2003</u> <u>Total</u>	<u>2002</u> <u>Total</u>
<b>ADDITIONS</b>							
Employers' contributions	\$ 15,883	\$ 65,335	\$ 45,244	\$ 99,235	\$ 7,654	\$ 233,351	\$ 267,260
<b>Total contributions</b>	15,883	65,335	45,244	99,235	7,654	233,351	267,260
<b>INVESTMENT INCOME</b>							
From investing activities							
Net appreciation (depreciation) in fair value of investments	719	146	1,735	3,576	96	6,272	(134,227)
Demutualization proceeds	-	-	-	-	-	-	61,603
Interest	684	2,582	1,175	2,287	413	7,141	13,147
Dividends	<u>1,453</u>	<u>5,482</u>	<u>2,496</u>	<u>4,857</u>	<u>876</u>	<u>15,164</u>	<u>7,149</u>
<b>Total income (loss) from investing activities</b>	2,856	8,210	5,406	10,720	1,385	28,577	(52,328)
<b>Investment activities expense</b>	52	183	84	170	33	522	451
<b>Commissions</b>	<u>35</u>	<u>138</u>	<u>63</u>	<u>121</u>	<u>21</u>	<u>378</u>	<u>430</u>
<b>Total investing activities expense</b>	<u>87</u>	<u>321</u>	<u>147</u>	<u>291</u>	<u>54</u>	<u>900</u>	<u>881</u>
<b>Net investing activities income (loss)</b>	<u>2,769</u>	<u>7,889</u>	<u>5,259</u>	<u>10,429</u>	<u>1,331</u>	<u>27,677</u>	<u>(53,209)</u>
<b>From Securities Lending Activities</b>							
Securities lending income	364	872	546	1,036	162	2,980	4,242
Securities lending expense:							
Security borrower rebates	281	670	418	792	125	2,286	3,325
Security lending agent fees	<u>17</u>	<u>41</u>	<u>26</u>	<u>48</u>	<u>8</u>	<u>140</u>	<u>186</u>
<b>Net income from securities lending activities</b>	<u>66</u>	<u>161</u>	<u>102</u>	<u>196</u>	<u>29</u>	<u>554</u>	<u>731</u>
<b>Total net investment income (loss)</b>	<u>2,835</u>	<u>8,050</u>	<u>5,361</u>	<u>10,625</u>	<u>1,360</u>	<u>28,231</u>	<u>(52,478)</u>
<b>Total Additions</b>	18,718	73,385	50,605	109,860	9,014	261,582	214,782

	<u>KERS</u> <u>Hazardous</u>	<u>KERS</u> <u>Non-Hazardous</u>	<u>CERS</u> <u>Hazardous</u>	<u>CERS</u> <u>Non-Hazardous</u>	<u>State</u> <u>Police</u>	<u>2003</u> <u>Total</u>	<u>2002</u> <u>Total</u>
<b>DEDUCTIONS</b>							
Healthcare premiums subsidies	\$ 2,938	\$ 51,586	\$ 14,866	\$ 39,387	\$ 4,519	\$ 113,296	\$ 96,104
Administrative fees	<u>27</u>	<u>393</u>	<u>105</u>	<u>306</u>	<u>31</u>	<u>862</u>	<u>778</u>
<b>Total deductions</b>	<u>2,965</u>	<u>51,979</u>	<u>14,971</u>	<u>39,693</u>	<u>4,550</u>	<u>114,158</u>	<u>96,882</u>
<b>Net increase in plan assets</b>	15,753	21,406	35,634	70,167	4,464	147,424	117,900
<b>Plan net assets held in trust for post-employment healthcare benefit</b>							
<b>Beginning of Year</b>	<u>109,769</u>	<u>465,665</u>	<u>187,534</u>	<u>365,333</u>	<u>68,074</u>	<u>1,196,375</u>	<u>1,078,475</u>
<b>End of Year</b>	<u>\$ 125,522</u>	<u>\$ 487,071</u>	<u>\$ 223,168</u>	<u>\$ 435,500</u>	<u>\$ 72,538</u>	<u>\$ 1,343,799</u>	<u>\$ 1,196,375</u>

See accompanying independent auditor's report and notes to financial statements.

## **KENTUCKY RETIREMENT SYSTEMS**

# **NOTES TO FINANCIAL STATEMENTS**

*June 30, 2003 and 2002*

Under the provisions of Kentucky Revised Statute Section 61.645, the Board of Trustees of Kentucky Retirement Systems (KRS) administers the Kentucky Employees Retirement System (KERS), County Employees Retirement System (CERS), and State Police Retirement System (SPRS). Although the assets of the plans are commingled for investment purposes, each plan's assets may be used only for the payment of benefits to the members of that plan, in accordance with the provisions of Kentucky Revised Statute Sections 16.555, 61.570, and 78.630.

Under the provisions of Kentucky Revised Statute Section 61.701, the Board of Trustees of Kentucky Retirement Systems (KRS) administers the Kentucky Retirement Systems Insurance Fund. The statutes provide for a single insurance fund to provide group hospital and medical benefits to retirees drawing a benefit from the three pension funds administered by Kentucky Retirement Systems: (1) Kentucky Employees Retirement System (KERS); (2) County Employees Retirement System (CERS); and (3) State Police Retirement System (SPRS). KRS maintains separate accounting records for five insurance funds which also includes hazardous duty members of the Kentucky Employees and County Employees Retirement Systems. The assets of the various insurance funds are commingled for investment purposes. The following notes apply to the various funds administered by Kentucky Retirement Systems.

### **NOTE A--SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

Basis of Accounting - KRS's financial statements are prepared using the accrual basis of accounting. Plan member contributions are recognized in the period in which contributions are due. Employer contributions to the plan are recognized when due and the employer has made a formal commitment to provide the contributions. Benefits and refunds are recognized when due and payable in accordance with terms of the plan. Premium payments are recognized when due and payable in accordance with terms of the plan.

Method Used to Value Investments - Investments are reported at fair value. Short-term investments are reported at cost, which approximates fair value. Securities traded on a national exchange are valued at the last reported sales price at current exchange rates. The fair value of real estate is based on appraisals. Investments that do not have an established market are reported at estimated fair value.

Estimates - The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

Equipment - Equipment is valued at historical cost and depreciation is computed utilizing the straight-line method over the estimated useful lives of the assets ranging from three to ten years.

Expense Allocation - Administrative and investment expenses of the Kentucky Retirement Systems are allocated in proportion to the number of active members participating in each plan and the carrying value of plan investments, respectively.

Reclassification - Certain amounts in 2002 have been reclassified to conform with the 2003 presentation. Such reclassifications had no effect on reported increase or decrease in plan net assets.

**KENTUCKY RETIREMENT SYSTEMS**  
**NOTES TO FINANCIAL STATEMENTS--CONTINUED**  
**June 30, 2003 and 2002**

**NOTE A--SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES--CONTINUED**

Component Unit - Kentucky Retirement Systems is a component unit of the Commonwealth of Kentucky. As such, the Commonwealth of Kentucky is the primary government in whose financial reporting entity the System is included.

The Kentucky Employees Retirement System was created by the Kentucky General Assembly pursuant to the provisions of KRS 61.515. The County Employees Retirement System was created by the Kentucky General Assembly pursuant to the provisions of KRS 78.520. The State Police Retirement System was created by the Kentucky General Assembly pursuant to the provisions of KRS 16.510. The Kentucky Retirement Systems Insurance Fund consisting of the Kentucky Employees Insurance Fund, Kentucky Employee Hazardous Insurance Fund, County Employees Insurance Fund, County Employees Hazardous Insurance Fund and State Police Insurance Fund was created by the Kentucky General Assembly pursuant to the provisions of KRS 61.701. The Retirement Systems' and Insurance Fund's administrative budget is subject to approval by the Kentucky General Assembly. Employer contribution rates for KERS and SPRS are also subject to legislative approval. Employer contribution rates for CERS are determined by the Systems' Board of Trustees without further legislative review. The methods used to determine the employer rates for all Retirement Systems are specified in KRS 61.565. Employee contribution rates are set by statute and may be changed only by the Kentucky General Assembly.

**NOTE B--PLAN DESCRIPTIONS AND CONTRIBUTION INFORMATION**

Membership of each Retirement plan consisted of the following at June 30, 2003 and 2002:

**KENTUCKY EMPLOYEES RETIREMENT SYSTEM**

	2003			2002		
	Non-Hazardous Position Employees	Hazardous Position Employees	Total	Non-Hazardous Position Employees	Hazardous Position Employees	Total
<u>Number of Members</u>						
Retirees and beneficiaries receiving benefits	27,182	1,365	28,547	26,703	1,208	27,911
Inactive Vested Retirements	3,892	169	4,061	3,415	127	3,542
Inactive Vested Memberships	17,320	1,233	18,553	14,299	946	15,245
Active plan members	<u>49,586</u>	<u>4,203</u>	<u>53,789</u>	<u>48,555</u>	<u>4,211</u>	<u>52,766</u>
 Total	 <u>97,980</u>	 <u>6,970</u>	 <u>104,950</u>	 <u>92,972</u>	 <u>6,492</u>	 <u>99,464</u>
 Number of participating employers			 410			 404

**KENTUCKY RETIREMENT SYSTEMS  
NOTES TO FINANCIAL STATEMENTS--CONTINUED  
June 30, 2003 and 2002**

**NOTE B--PLAN DESCRIPTIONS AND CONTRIBUTION INFORMATION--CONTINUED**

**COUNTY EMPLOYEES RETIREMENT SYSTEM**

	2003			2002		
	Non-Hazardous Position <u>Employees</u>	Hazardous Position <u>Employees</u>	<u>Total</u>	Non-Hazardous Position <u>Employees</u>	Hazardous Position <u>Employees</u>	<u>Total</u>
<u>Number of Members</u>						
Retirees and beneficiaries						
receiving benefits	27,057	3,787	30,844	26,147	3,483	29,630
Inactive Vested Retirements	5,147	193	5,340	4,470	148	4,618
Inactive Vested Memberships	30,573	873	31,446	26,508	552	27,060
Active plan members	<u>83,142</u>	<u>9,587</u>	<u>92,729</u>	<u>79,850</u>	<u>8,949</u>	<u>88,799</u>
 Total	 <u>145,919</u>	 <u>14,440</u>	 <u>160,359</u>	 <u>136,975</u>	 <u>13,132</u>	 <u>150,107</u>
 Number of participating employers			 1,367			 1,314

**STATE POLICE RETIREMENT SYSTEM**

	<u>2003</u>	<u>2002</u>
	Hazardous Position <u>Employees</u>	Hazardous Position <u>Employees</u>
<u>Number of Members</u>		
Retirees and beneficiaries		
receiving benefits	966	897
Inactive Vested Retirements	43	20
Inactive Vested Memberships	186	83
Active plan members	<u>1,022</u>	<u>1,002</u>
 Total	 2,217	 2,002
 Number of participating employers	 1	 1

**KENTUCKY RETIREMENT SYSTEMS  
NOTES TO FINANCIAL STATEMENTS--CONTINUED  
June 30, 2003 and 2002**

**NOTE B--PLAN DESCRIPTIONS AND CONTRIBUTION INFORMATION--CONTINUED**

**KENTUCKY RETIREMENT SYSTEMS INSURANCE FUND**

Hospital and medical contracts in force consisted of the following at June 30, 2003 and 2002:

	2003					2002				
	Single	Couple/ Family	Parent + Regular	Medicare Regular	Medicare High	Single	Couple/ Family	Parent + Regular	Medicare Regular	Medicare High
KERS Non-Hazardous	6,602	1,298	428	1,855	11,311	5,822	1,182	396	1,838	11,229
KERS Hazardous	417	234	53	62	494	359	205	57	66	451
CERS Non-Hazardous	5,054	855	244	2,630	9,958	4,530	800	224	2,446	9,517
CERS Hazardous	1,010	1,379	223	40	808	956	1,321	210	38	734
SPRS	<u>218</u>	<u>384</u>	<u>44</u>	<u>13</u>	<u>312</u>	<u>199</u>	<u>364</u>	<u>50</u>	<u>11</u>	<u>303</u>
Totals	13,301	4,150	992	4,600	22,883	11,866	3,872	937	4,399	22,234

**KENTUCKY EMPLOYEES RETIREMENT SYSTEM**

**Non-Hazardous Employees Pension Plan**

Plan Description - KERS is a cost-sharing multiple-employer defined benefit pension plan that covers substantially all regular full-time members employed in non-hazardous duty positions of any state department, board, or agency directed by Executive Order to participate in the System. The plan provides for retirement, disability, and death benefits to plan members. Retirement benefits may be extended to beneficiaries of plan members under certain circumstances. Cost-of-living (COLA) adjustments are provided annually equal to the percentage increase in the annual average of the consumer price index for all urban consumers for the most recent calendar year, not to exceed five percent in any plan year. The General Assembly reserves the right to suspend or reduce cost-of-living adjustments if in its judgment the welfare of the Commonwealth so demands.

Contributions - For the years ended June 30, 2003 and 2002, plan members were required to contribute 5% of their annual creditable compensation. The State was required to contribute at an actuarially determined rate. Per Kentucky Revised Statute Section 61.565(3), normal contribution and past service contribution rates shall be determined by the Board on the basis of an annual valuation last preceding the July 1 of a new biennium. The Board may amend contribution rates as of the first day of July of the second year of a biennium, if it is determined on the basis of a subsequent actuarial valuation that amended contribution rates are necessary to satisfy requirements determined in accordance with actuarial bases adopted by the Board. However, formal commitment to provide the contributions by the employer is made through the biennial budget. For the year ended June 30, 2003, the contribution rate for some employers participating in KERS was 3.76% of creditable compensation and 5.89% of creditable compensation for some KERS employers pursuant to legislation enacted by the 2003 General Assembly [HB269, FCCR1, Part III, General Provisions, Paragraph 18 (2003)]. For the year ended June 30, 2002, the rate was 5.89%. The actuarially determined rate set by the Board for the years ended June 30, 2003 and 2002 was 5.89% of creditable compensation. Administrative costs of Kentucky Retirement Systems are financed through employer contributions and investment earnings.

**KENTUCKY RETIREMENT SYSTEMS**  
**NOTES TO FINANCIAL STATEMENTS--CONTINUED**  
**June 30, 2003 and 2002**

**NOTE B--PLAN DESCRIPTIONS AND CONTRIBUTION INFORMATION--CONTINUED**

**Hazardous Employees Pension Plan**

Plan Description - KERS is a cost-sharing multiple-employer defined benefit pension plan that covers substantially all regular full-time members employed in hazardous duty positions of any state department, board, or agency directed by Executive Order to participate in the System. The plan provides for retirement, disability, and death benefits to plan members. Retirement benefits may be extended to beneficiaries of plan members under certain circumstances. Cost-of-living (COLA) adjustments are provided annually equal to the percentage increase in the annual average of the consumer price index for all urban consumers for the most recent calendar year, not to exceed five percent in any plan year. The General Assembly reserves the right to suspend or reduce cost-of-living adjustments if in its judgment the welfare of the Commonwealth so demands.

Contributions - For the years ended June 30, 2003 and 2002, plan members were required to contribute 8% of their annual creditable compensation. The State was required to contribute at an actuarially determined rate. Per Kentucky Revised Statute Section 61.565(3), normal contribution and past service contribution rates shall be determined by the Board on the basis of an annual valuation last preceding the July 1 of a new biennium. The Board may amend contribution rates as of the first day of July of the second year of a biennium, if it is determined on the basis of a subsequent actuarial valuation that amended contribution rates are necessary to satisfy requirements determined in accordance with actuarial bases adopted by the Board. However, formal commitment to provide the contributions by the employer is made through the biennial budget. For the year ended June 30, 2003, the contribution rate for some employers participating in KERS was 17.60% and for some employers in KERS was 18.84% of creditable compensation pursuant to legislation enacted by the 2003 General Assembly [HB269, FCCR1, Part III, General Provisions, Paragraph 18 (2003)]. For the year ended June 30, 2002, the rate was 18.84%. The actuarially determined rate set by the Board for the years ended June 30, 2003 and 2002 was 18.84% of creditable compensation. Administrative costs of Kentucky Retirement Systems are financed through employer contributions and investment earnings.

**COUNTY EMPLOYEES RETIREMENT SYSTEM**

**Non-Hazardous Employees Pension Plan**

Plan Description - CERS is a cost-sharing multiple-employer defined benefit pension plan that covers substantially all regular full-time members employed in non-hazardous duty positions of each county and school board, and any additional eligible local agencies electing to participate in the System. The plan provides for retirement, disability, and death benefits to plan members. Retirement benefits may be extended to beneficiaries of plan members under certain circumstances. Cost-of-living (COLA) adjustments are provided at the discretion of the State legislature.

**KENTUCKY RETIREMENT SYSTEMS**  
**NOTES TO FINANCIAL STATEMENTS--CONTINUED**  
**June 30, 2003 and 2002**

**NOTE B--PLAN DESCRIPTIONS AND CONTRIBUTION INFORMATION--CONTINUED**

Contributions - For the years ended June 30, 2003 and 2002, plan members were required to contribute 5% of their annual creditable compensation. Participating employers were required to contribute at an actuarially determined rate. Per Kentucky Revised Statute Section 61.565(3), normal contribution and past service contribution rates shall be determined by the Board on the basis of an annual valuation last preceding the July 1 of a new biennium. The Board may amend contribution rates as of the first day of July of the second year of a biennium, if it is determined on the basis of a subsequent actuarial valuation that amended contribution rates are necessary to satisfy requirements determined in accordance with actuarial bases adopted by the Board. For the years ended June 30, 2003 and 2002, participating employers contributed 6.34% and 6.41%, respectively, of each employee's creditable compensation. The actuarially determined rate set by the Board for the years ended June 30, 2003 and 2002 was 6.34% and 6.41%, respectively. Administrative costs of Kentucky Retirement Systems are financed through employer contributions and investment earnings.

**Hazardous Employees Pension Plan**

Plan Description - CERS is a cost-sharing multiple-employer defined benefit pension plan that covers substantially all regular full-time members employed in hazardous duty positions of each county and school board, and any additional eligible local agencies electing to participate in the System. The plan provides for retirement, disability, and death benefits to plan members. Retirement benefits may be extended to beneficiaries of plan members under certain circumstances. Cost-of-living (COLA) adjustments are provided at the discretion of the State legislature.

Contributions - For the years ended June 30, 2003 and 2002, plan members were required to contribute 8% of their annual creditable compensation. The participating employers were required to contribute at an actuarially determined rate. Per Kentucky Revised Statute Section 61.565(3), normal contribution and past service contribution rates shall be determined by the Board on the basis of an annual valuation last preceding the July 1 of a new biennium. The Board may amend contribution rates as of the first day of July of the second year of a biennium, if it is determined on the basis of a subsequent actuarial valuation that amended contribution rates are necessary to satisfy requirements determined in accordance with actuarial bases adopted by the Board. For the years ended June 30, 2003 and 2002, participating employers contributed 16.28% of each employee's creditable compensation. The actuarially determined rate set by the Board for the years ended June 30, 2003 and 2002 was 16.28% of creditable compensation. Administrative costs of KRS are financed through employer contributions and investment earnings.

**STATE POLICE RETIREMENT SYSTEM**

Plan Description - SPRS is a single-employer defined benefit pension plan that covers all full-time State Troopers employed in a hazardous duty position by the Kentucky State Police. The plan provides for retirement, disability, and death benefits to plan members. Retirement benefits may be extended to beneficiaries of plan members under certain circumstances. Cost-of-living (COLA) adjustments are provided at the discretion of the State legislature.

**KENTUCKY RETIREMENT SYSTEMS  
NOTES TO FINANCIAL STATEMENTS--CONTINUED  
June 30, 2003 and 2002**

**NOTE B--PLAN DESCRIPTIONS AND CONTRIBUTION INFORMATION--CONTINUED**

Contributions - For the years ended June 30, 2003 and 2002 plan members were required to contribute 8% of their annual creditable compensation. The State was required to contribute at an actuarially determined rate. Per Kentucky Revised Statute Section 61.565(3), normal contribution and past service contribution rates shall be determined by the Board on the basis of an annual valuation last preceding the July 1 of a new biennium. The Board may amend contribution rates as of the first day of July of the second year of a biennium, if it is determined on the basis of a subsequent actuarial valuation that amended contribution rates are necessary to satisfy requirements determined in accordance with actuarial bases adopted by the Board. However, formal commitment to provide the contributions by the employer is made through the biennial budget. For the years ended June 30, 2003 and 2002, the State contributed 17.37% and 21.58%, respectively, of each employee's creditable compensation. The actuarially determined rate set by the Board for the years ended June 30, 2003 and 2002 was 21.58% of creditable compensation. Administrative costs of Kentucky Retirement System are financed through employer contributions and investment earnings.

**KENTUCKY RETIREMENT SYSTEMS INSURANCE FUND**

Plan Description - The Kentucky Retirement Systems Insurance Fund (Fund) was established to provide hospital and medical insurance for members receiving benefits from the Kentucky Employees Retirement System, the County Employees Retirement System, and the State Police Retirement System (Systems). The Fund pays a prescribed contribution for whole or partial payment of required premiums to purchase hospital and medical insurance. For the year insurance premiums withheld from benefit payments to members of the Systems approximated \$22,384,767 and \$659,533 for KERS and KERS hazardous, respectively, \$20,456,708 and \$2,242,457 for CERS and CERS hazardous, respectively, and \$581,251 for SPRS. The Fund pays the same proportion of hospital and medical insurance premiums for the spouse and dependents of retired hazardous members killed in the line of duty. As of June 30, 2003 the Fund had 60,357 retirees and beneficiaries for whom benefits were available.

The amount of contribution paid by the Fund is based on years of service with the Systems. Years of service and respective percentages of the maximum contribution are as follows:

<u>Years of Service</u>	<u>Percent Paid by Insurance Fund</u>
20 or More	100%
15 - 19	75%
10 - 14	50%
4 - 9	25%
Less Than 4	0%

In prior years, the employers' required medical insurance contribution rate was being increased annually by a percentage that would result in advance-funding the medical liability on an actuarially determined basis using the entry age normal cost method within a 20-year period measured from 1987. In November 1992, the Board of Trustees adopted a fixed percentage contribution rate and suspended future increases under the current medical premium funding policy until the next experience study could be performed.

In May 1996, the Board of Trustees adopted a policy to increase the insurance contribution rate by the amount needed to achieve the target rate for full entry age normal funding within twenty years. The increases commenced with the 1997 valuation and adjustments will be made every other valuation year to coincide with the valuation used by the General Assembly to establish employer contribution rates for the biennium.

**KENTUCKY RETIREMENT SYSTEMS**  
**NOTES TO FINANCIAL STATEMENTS--CONTINUED**  
**June 30, 2003 and 2002**

**NOTE C--CASH AND SHORT-TERM INVESTMENTS AND SECURITIES LENDING COLLATERAL**

The provisions of Governmental Accounting Standards Board Statement No. 28, "Accounting and Financial Reporting for Securities Lending Transactions" require that cash received as collateral on securities lending transactions and investments made with that cash be reported as assets on the financial statements. In conjunction with the adoption of Governmental Accounting Standard No. 28, the System has reclassified certain other investments, not related to the securities lending program, as short-term. Cash and short-term investments consist of the following:

**KENTUCKY EMPLOYEES RETIREMENT SYSTEM**

	2003	2002
Miscellaneous cash	\$ 525,299	\$ 12,580,710
Short-Term Investment Pool	1,656,597,564	1,318,840,638
Repurchase agreements	170,917,610	260,745,038
Total	<u>\$1,828,040,473</u>	<u>\$ 1,592,166,386</u>

**COUNTY EMPLOYEES RETIREMENT SYSTEM**

	2003	2002
Miscellaneous Cash	\$ 832,473	\$ 14,647,210
Short-Term Investment Pool	1,686,604,839	1,308,851,954
Repurchase agreements	306,549,501	269,469,918
Total	<u>\$1,993,986,813</u>	<u>\$ 1,592,969,082</u>

**STATE POLICE RETIREMENT SYSTEM**

	2003	2002
Miscellaneous Cash	134,759	1,266,091
Short-Term Investment Pool	100,961,178	81,837,844
Repurchase agreements	8,285,357	17,843,020
Total	<u>\$ 109,381,294</u>	<u>\$ 100,946,955</u>

**KENTUCKY RETIREMENT SYSTEMS INSURANCE FUND**

	2003	2002
Miscellaneous Cash	215,516	24,939,638
Short-Term Investment Pool	344,416,324	204,492,843
Repurchase agreements	147,009,999	142,008,460
Total	<u>\$ 491,641,839</u>	<u>\$ 371,440,941</u>

**KENTUCKY RETIREMENT SYSTEMS**  
**NOTES TO FINANCIAL STATEMENTS--CONTINUED**  
**June 30, 2003 and 2002**

**NOTE D--INVESTMENTS**

The Board of Trustees of the Retirement Systems and Insurance Fund recognize their duty to invest funds in accordance with the Prudent Person Rule and manage those funds consistent with the long-term nature of the Systems. The Board enters into contracts with investment managers who use the following guidelines and restrictions in the selection and timing of transactions as long as the security is not prohibited by the Kentucky Revised Statutes.

Equity Investments - Investments may be made in domestic and international common stock, securities convertible into common stock and in preferred stock of publicly traded corporations.

Fixed Income Investments - Publicly traded corporate bonds are to be selected and managed to assure an appropriate balance in quality and maturities consistent with the current market and economic conditions. Investment may also be made in any debt instrument issued or guaranteed in whole or in part by the U.S. Government or any agency or instrumentality of the U.S. Government.

Mortgages - Investment may be made in real estate mortgages on a direct basis or in the form of mortgage pool instruments guaranteed by an agency of the U.S. Government or the Commonwealth of Kentucky.

Alternative Investments/Equity Real Estate – Subject to the specific approval of the investment committee of the board of trustees, investments may be made for the purpose of creating a diversified portfolio of alternative investments. The board may invest in real estate or alternative investments including, without limitation, venture capital, private equity and private placements which the investment committee believes has excellent potential to generate income and which may have a higher degree of risk.

Cash Equivalent Securities - The following short-term investment vehicles are considered acceptable:

Publicly traded investment grade corporate bonds, government and agency bonds, mortgages, and collective STIF's, money market funds or instruments (including, but not limited to, certificates of deposit, bank notes, deposit notes, bankers' acceptances and commercial paper) and repurchase agreements relating to the above instruments. Instruments may be selected from among those having a BBB or better rating by at least one recognized bond rating service. All instruments shall have a maturity at the time of purchase that does not exceed two years. Repurchase agreements shall be deemed to have a maturity equal to the period remaining until the date on which the repurchase of the underlying securities is scheduled to occur.

Derivatives – Investments may be made in derivative securities, or strategies which make use of derivative instruments, only if such investments do not cause the portfolio to be in any way leveraged beyond a 100% invested position. Investments in derivative securities which are subject to large or unanticipated changes in duration or cash flow, such as interest only (IO), principal only (PO), inverse floater, or structured note securities are expressly prohibited.

The Retirement Systems and Insurance Fund invest in collateral mortgage obligations (CMOs) and other asset-backed securities to increase return and adjust duration of the portfolio. The Systems and the Fund invest in exchange-traded funds to convert cash held in index funds to short-term equity investments. This practice is intended to make the performance of the index funds more closely track the performance of the index that the funds are intended to replicate.

**KENTUCKY RETIREMENT SYSTEMS**  
**NOTES TO FINANCIAL STATEMENTS--CONTINUED**  
**June 30, 2003 and 2002**

**NOTE D--INVESTMENTS--CONTINUED**

Collateral mortgage obligations, asset-backed securities, and exchange-traded funds pose no greater risk than other similar investment grade holdings in the Systems' and the Fund's portfolios. The fair value of CMOs at June 30, 2003 and 2002 was approximately \$80 million and \$137 million respectively; the fair value of asset-backed securities at June 30, 2003 and 2002 was approximately \$310 million and \$141 million respectively; and the fair value of exchange-traded funds at June 30, 2003 and 2002 was approximately \$188 million and \$191 million, respectively.

The Retirement Systems' and Insurance Fund's investments are categorized on pages 36 through 39 to give an indication of the level of risk assumed by them at June 30, 2003 and 2002. Category 1 includes investments that are either insured or registered or for which the investments are held by the System or its agent in the System's name. Category 3 includes securities purchased by and held by the System's custodial agent. The agent loans securities owned by the Systems and Fund with the simultaneous receipt of cash collateral. The custodial agent purchases securities with the cash collateral in accordance with the Systems' and Fund's Statement of Investment Policy. All securities purchased with cash collateral are segregated by the custodial agent and held in the name of Kentucky Retirement Systems. At June 30, 2003, the systems had a second agent who also loans securities owned by the systems with the simultaneous receipt of cash collateral. The second custodial agent invests cash collateral in a short-term investment pool that holds only U.S. dollar cash and U.S. securities.

**KENTUCKY RETIREMENT SYSTEMS**  
**NOTES TO FINANCIAL STATEMENTS--CONTINUED**  
**June 30, 2003 and 2002**

**NOTE D--INVESTMENTS--CONTINUED**

**KENTUCKY EMPLOYEES RETIREMENT SYSTEM**

<b>Investments - Categorized</b>	2003			<b>Fair Value</b>
	Category 1	Category 2	Category 3	
U.S. Government Securities	\$ 669,755,421	\$ -	\$ 3,809,832	\$ 673,565,253
Loaned for securities collateral	48,609,045	-	-	48,609,045
Corporate bonds	588,972,872	-	-	588,972,872
Corporate stocks	2,299,125,931	-	130	2,299,126,062
Loaned for securities collateral	1,719,201	-	-	1,719,201
Repurchase agreements	<u>167,987,935</u>	<u>-</u>	<u>2,929,676</u>	<u>170,917,610</u>
Subtotal	3,776,170,405	-	6,739,638	3,782,910,043
<b>Investments - Not Categorized</b>				
Short-term Investment Pool	-	-	-	1,656,597,564
Investments held by broker-dealers under securities loans:				
U.S. Government Securities	-	-	-	504,017,197
Corporate bonds	-	-	-	61,722,729
Corporate stocks	-	-	-	561,512,794
Mortgages	-	-	-	273,115,545
Real Estate Investment	<u>-</u>	<u>-</u>	<u>-</u>	<u>8,635,101</u>
Total Investments	<u>\$3,776,170,405</u>	<u>\$ -</u>	<u>\$ 6,739,638</u>	<u>\$6,848,510,973</u>

<b>Investments - Categorized</b>	2002			<b>Fair Value</b>
	Category 1	Category 2	Category 3	
U.S. Government Securities	\$ 113,768,072	\$ -	\$ 6,257,731	\$ 120,025,803
Loaned for securities collateral	250,546,768	-	-	250,546,768
Corporate bonds	545,042,869	-	-	545,042,869
Loaned for securities collateral	5,102,948	-	-	5,102,948
Corporate stocks	2,452,194,242	-	129	2,452,194,371
Loaned for securities collateral	444,848	-	-	444,848
Repurchase agreements	<u>259,255,343</u>	<u>-</u>	<u>1,495,823</u>	<u>260,751,166</u>
Subtotal	3,626,355,090	-	7,753,683	3,634,108,773
<b>Investments - Not Categorized</b>				
Short-term Investment Pool	-	-	-	1,318,840,638
Investments held by broker-dealers under securities loans:				
U.S. Government Securities	-	-	-	806,544,819
Corporate bonds	-	-	-	67,680,028
Corporate stocks	-	-	-	403,320,388
Mortgages	-	-	-	313,339,066
Real Estate Investment	<u>-</u>	<u>-</u>	<u>-</u>	<u>11,103,333</u>
Total Investments	<u>\$3,626,335,090</u>	<u>\$ -</u>	<u>\$ 7,753,683</u>	<u>\$6,554,937,045</u>

**KENTUCKY RETIREMENT SYSTEMS**  
**NOTES TO FINANCIAL STATEMENTS--CONTINUED**  
**June 30, 2003 and 2002**

**NOTE D--INVESTMENTS--CONTINUED**

**COUNTY EMPLOYEES RETIREMENT SYSTEM**

<b>Investments - Categorized</b>	2003			<b>Fair Value</b>
	<u>Category 1</u>	<u>Category 2</u>	<u>Category 3</u>	
U.S. Government Securities	\$ 209,130,474	\$ -	\$ 3,879,310	\$ 213,009,784
Loaned for securities collateral	483,521,727	-	-	483,521,727
Corporate bonds	574,044,312	-	-	574,044,312
Loaned for securities collateral	5,047,609	-	-	5,047,609
Corporate stocks	2,265,011,128	-	133	2,265,011,261
Loaned for securities collateral	13,724,905	-	-	13,724,905
Repurchase agreements	<u>303,566,399</u>	<u>-</u>	<u>2,983,102</u>	<u>306,549,501</u>
Subtotal	3,854,046,554	-	6,862,545	3,860,909,099
<b>Investments - Not Categorized</b>				
Short-Term Investment Pool	-	-	-	1,686,604,839
Investments held by broker-dealers under securities loans:				
U.S. Government Securities	-	-	-	513,146,864
Corporate bonds	-	-	-	62,840,762
Corporate stocks	-	-	-	571,683,924
Mortgages	-	-	-	269,920,205
Real Estate Investment	<u>-</u>	<u>-</u>	<u>-</u>	<u>7,796,669</u>
Total Investments	<u>\$3,854,046,554</u>	<u>\$ -</u>	<u>\$ 6,862,545</u>	<u>\$6,972,902,362</u>

<b>Investments - Categorized</b>	2002			<b>Fair Value</b>
	<u>Category 1</u>	<u>Category 2</u>	<u>Category 3</u>	
U.S. Government Securities	\$ 106,558,508	\$ -	\$ 6,176,452	\$ 112,734,960
Loaned for securities collateral	248,649,168	-	-	248,649,168
Corporate bonds	537,565,238	-	-	537,565,238
Loaned for securities collateral	5,064,299	-	-	5,064,299
Corporate stocks	2,433,226,793	-	124	2,433,226,917
Loaned for securities collateral	441,479	-	-	441,479
Repurchase agreements	<u>267,991,504</u>	<u>-</u>	<u>1,478,414</u>	<u>269,469,918</u>
Subtotal	3,599,496,989	-	7,654,990	3,607,151,979
<b>Investments - Not Categorized</b>				
Short-Term Investment Pool	-	-	-	1,308,851,954
Investments held by broker-dealers under securities loans:				
U.S. Government Securities	-	-	-	800,442,229
Corporate bonds	-	-	-	67,167,431
Corporate stocks	-	-	-	400,265,705
Mortgages	-	-	-	309,695,477
Real Estate Investment	<u>-</u>	<u>-</u>	<u>-</u>	<u>9,580,920</u>
Total Investments	<u>\$3,599,496,989</u>	<u>\$ -</u>	<u>\$ 7,654,990</u>	<u>\$6,503,155,695</u>

**KENTUCKY RETIREMENT SYSTEMS**  
**NOTES TO FINANCIAL STATEMENTS--CONTINUED**  
**June 30, 2003 and 2002**

**NOTE D--INVESTMENTS--CONTINUED**

**STATE POLICE RETIREMENT SYSTEM**

<b>Investments - Categorized</b>	2003			<b>Fair Value</b>
	<u>Category 1</u>	<u>Category 2</u>	<u>Category 3</u>	
U.S. Government Securities	\$ 16,405,761	\$ -	\$ 232,170	\$ 16,637,931
Loaned for securities collateral	28,943,901	-	-	28,943,901
Corporate bonds	36,425,347	-	-	36,425,347
Loaned for securities collateral	302,153	-	-	302,153
Corporate stocks	138,380,614	-	8	138,380,622
Loaned for securities collateral	821,581	-	-	821,581
Repurchase agreements	<u>8,106,824</u>	<u>-</u>	<u>178,533</u>	<u>8,285,357</u>
Subtotal	229,386,181	-	410,711	229,796,892
<b>Investments - Not Categorized</b>				
Short-Term Investment Pool	-	-	-	100,961,178
Investments held by broker-dealers under securities loans:				
U.S. Government Securities	-	-	-	30,717,279
Corporate bonds	-	-	-	3,761,686
Corporate stocks	-	-	-	34,221,343
Mortgages	-	-	-	16,969,831
Real Estate Investment	<u>-</u>	<u>-</u>	<u>-</u>	<u>823,918</u>
Total Investments	<u>\$ 229,386,181</u>	<u>\$ -</u>	<u>\$ 410,711</u>	<u>\$ 417,252,127</u>

<b>Investments - Categorized</b>	2002			<b>Fair Value</b>
	<u>Category 1</u>	<u>Category 2</u>	<u>Category 3</u>	
U.S. Government Securities	\$ 8,834,473	\$ -	\$ 397,807	\$ 9,232,280
Loaned for securities collateral	15,547,146	-	-	15,547,146
Corporate bonds	34,758,002	-	-	34,758,002
Loaned for securities collateral	316,653	-	-	316,653
Corporate stocks	146,882,275	-	-	146,882,275
Loaned for securities collateral	27,604	-	-	27,604
Repurchase agreements	<u>17,750,580</u>	<u>-</u>	<u>92,440</u>	<u>17,843,020</u>
Subtotal	224,116,733	-	490,247	224,606,980
<b>Investments - Not Categorized</b>				
Short-Term Investment Pool	-	-	-	81,837,844
Investments held by broker-dealers under securities loans:				
U.S. Government Securities	-	-	-	50,048,419
Corporate bonds	-	-	-	4,199,740
Corporate stocks	-	-	-	25,027,187
Mortgages	-	-	-	19,484,961
Real Estate Investment	<u>-</u>	<u>-</u>	<u>-</u>	<u>1,014,934</u>
Total Investments	<u>\$ 224,116,733</u>	<u>\$ -</u>	<u>\$ 490,247</u>	<u>\$ 406,220,066</u>

**KENTUCKY RETIREMENT SYSTEMS**  
**NOTES TO FINANCIAL STATEMENTS--CONTINUED**  
**June 30, 2003 and 2002**

**NOTE D--INVESTMENTS--CONTINUED**

**KENTUCKY RETIREMENT SYSTEMS INSURANCE FUND**

<b>Investments - Categorized</b>	2003			<b>Fair Value</b>
	<u>Category 1</u>	<u>Category 2</u>	<u>Category 3</u>	
U.S. Government Securities	\$ -	\$ -	\$ -	\$ -
Loaned for securities collateral	104,484,853	-	-	104,484,853
Corporate stocks	827,298,990	-	-	827,298,990
Loaned for securities collateral	16,750,685	-	-	16,750,685
Repurchase agreements	<u>145,186,891</u>	<u>-</u>	<u>1,823,108</u>	<u>147,009,999</u>
Subtotal	1,093,721,419	-	1,823,108	1,095,544,527
<b>Investments - Not Categorized</b>				
Short-term investment pool	-	-	-	344,416,324
Investments held by broker-dealers under securities loans:	-	-	-	28,755,858
U.S. Government Securities	-	-	-	195,316,898
Corporate stocks	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Mortgage	-	-	-	-
Total Investments	<u>\$1,093,721,419</u>	<u>\$ -</u>	<u>\$ 1,823,108</u>	<u>\$1,664,033,607</u>

<b>Investments - Categorized</b>	2002			<b>Fair Value</b>
	<u>Category 1</u>	<u>Category 2</u>	<u>Category 3</u>	
U.S. Government Securities	\$ 14,644,105	\$ -	\$ -	\$ 14,644,105
Loaned for securities collateral	12,342,559	-	-	12,342,559
Corporate stocks	758,949,817	-	-	758,949,817
Loaned for securities collateral	2,647,879	-	-	2,647,879
Repurchase agreements	<u>141,428,878</u>	<u>-</u>	<u>579,581</u>	<u>142,008,459</u>
Subtotal	930,013,238	-	579,581	930,592,819
<b>Investments - Not Categorized</b>				
Investments held by broker-dealers under securities loans:	-	-	-	204,492,842
U.S. Government Securities	-	-	-	92,779,528
Corporate stocks	<u>-</u>	<u>-</u>	<u>-</u>	<u>119,665,028</u>
Mortgages	-	-	-	-
Total Investments	<u>\$ 930,013,238</u>	<u>\$ -</u>	<u>\$ 579,581</u>	<u>\$1,347,530,217</u>

**NOTE E--SECURITIES LENDING TRANSACTIONS**

Kentucky Revised Statutes Sections 61.650 and 386.020(2) permit the Pension and Insurance Funds to lend their securities to broker-dealers and other entities. The borrowers of the securities agree to transfer to the Funds' custodial banks either cash collateral or other securities with a fair value of 102 percent of the value of the borrowed securities. The borrowers of the securities simultaneously agree to return the borrowed securities in exchange for the collateral at a later date. Securities lent for cash collateral are presented as unclassified above in the schedule of custodial credit risk; securities lent for securities collateral are classified according to the category for the securities loaned. At year-end, the Funds have no credit risk exposure to borrowers because the amounts the Funds owe to borrowers exceed the amounts the borrowers owe the Funds. The contracts with the custodial banks require them to indemnify the Funds if the borrowers fail to return the securities and one or both of the custodial banks have failed to live up to their contractual responsibilities relating to the lending of securities.

All securities loans can be terminated on demand by either party to the transaction, although the average term of the loans was 6 days, 10 days, and 24 days for the three investment portfolios subject to security lending agreements. One custodial bank invests cash collateral in securities that are permitted for investment by state statute and board policy, which at year-end has a weighted-average maturity of 3 days for the Funds. The other custodial bank invests cash collateral in the agent's short-term investment pool as permitted by state statute and Board policy, which at year-end has a weighted-average maturity of 24 days for the Pension Fund only. Neither of the Funds can pledge or sell collateral securities received unless the borrower defaults.

**NOTE F--RISKS OF LOSS**

KRS is exposed to various risks of loss related to torts; thefts of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. Under the provisions of the Kentucky Revised Statutes, the Kentucky Board of Claims is vested with full power and authority to investigate, hear proof, and to compensate persons for damages sustained to either person or property as a result of negligence of the agency or any of its employees. Awards are limited to \$200,000 for a single claim and \$350,000 in aggregate per occurrence. Awards and a pro rata share of the operating cost of the Board of Claims are paid from the fund of the agency having a claim or claims before the Board.

Claims against the Board of Trustees of Kentucky Retirement Systems or any of its staff as result of actual or alleged breach of fiduciary duty are insured with a commercial insurance policy. Coverage provided is limited to \$5,000,000 with a deductible amount of \$25,000. Defense costs incurred in defending such claims will be paid by the insurance company. However, the total defense cost and claims paid shall not exceed the total aggregate coverage of the policy.

Claims for job-related illnesses or injuries to employees are insured by the state's self-insured workers' compensation program. Payments approved by the program are not subject to maximum limitations. A claimant may receive reimbursement for all medical expenses related to the illness or injury and up to sixty-six and two-thirds percent (66 2/3%) of wages for temporary disability. Each agency pays premiums based on fund reserves and payroll.

**KENTUCKY RETIREMENT SYSTEMS**  
**NOTES TO FINANCIAL STATEMENTS--CONTINUED**  
**June 30, 2003 and 2002**

**NOTE F--RISKS OF LOSS--CONTINUED**

Only claims pertaining to workers' compensation have been filed during the past three fiscal years. Settlements did not exceed insurance coverage in any of the past three fiscal years. There were no claims which were appealed to the Kentucky Workers' Compensation Board.

**NOTE G--CONTINGENCIES**

In the normal course of business, KRS is involved in various litigation concerning the right of participants or their beneficiaries to receive benefits. KRS does not anticipate any material losses as a result of the contingent liabilities.

**NOTE H--INCOME TAX STATUS**

The Internal Revenue Service has ruled that KRS qualifies under Section 401(a) of the Internal Revenue Code and is, therefore, not subject to tax under income tax law.

**NOTE I--PRIOR PERIOD ADJUSTMENT**

The plan assets of KRS have been restated as of July 1, 2001 to reflect a change in accounting method in the recording of equipment acquisitions. Effective July 1, 2001, KRS changed to recording such equipment acquisitions as capital assets and providing for depreciation of such assets over their respective estimated useful lives utilizing the straight-line method of depreciation. KRS had previously recorded equipment acquisitions as an expense in the period acquired. The net affect of this change in accounting method was an increase of \$1,148,000 to plan net assets as of July 1, 2001.

**NOTE J--ANTHEM DEMUTUALIZATION**

In 2002, Anthem Insurance Companies, Inc., an Indiana corporation, underwent a demutualization, as authorized by the Indiana statutes. The demutualization provided, among other things, that "eligible statutory members", as defined by Indiana statutory provision, would receive cash or stock in consideration for giving up their membership interest in Anthem. In some instances application of the statute led to the determination by Anthem that individual members of the retirement plans administered by Kentucky Retirement Systems were the "statutory members" and in other instances the Kentucky Retirement Systems was identified by Anthem as the eligible statutory member to receive cash or stock under the Anthem demutualization plan. According to Anthem, this determination was based upon which of Anthem's subsidiaries was the original provider. The determination was confirmed by the Indiana Department of Insurance.

**KENTUCKY RETIREMENT SYSTEMS**  
**NOTES TO FINANCIAL STATEMENTS--CONTINUED**  
**June 30, 2003 and 2002**

**NOTE J--ANTHEM DEMUTUALIZATION--CONTINUED**

The \$61,603,207 distribution which Kentucky Retirement Systems received on January 4, 2002 under the Anthem demutualization was deposited in the Kentucky Employees Retirement Systems Insurance Fund. The retirement systems included within the Kentucky Retirement Systems for purposes of the Anthem demutualization are the Kentucky Employees Retirement System, (hazardous and non-hazardous), the County Employees Retirement System (hazardous and non-hazardous), the State Police Retirement System, the Legislators' Retirement Plan, and the Judicial Retirement Plan. Anthem has not yet provided the Kentucky Retirement System with the information necessary to divide the distribution among these retirement funds. Accordingly, the distribution will remain in the Kentucky Employees Retirement Systems Insurance Fund until the interests of the various retirement funds are determined. Given the unusual and non-recurring nature of the transaction, it is reported in these financial statements as a separate component of income.

**NOTE K--CONTINGENT LIABILITY--ANTHEM DEMUTUALIZATION**

In relation to the above noted Anthem demutualization, Kentucky Retirement System is a defendant in a case entitled Jean C. Love, David E. Wiseman and Belvia Campbell v. Board of Trustees of the Kentucky Retirement Systems, which is in Franklin Circuit Court. At issue is how to distribute the proceeds resulting from Anthem's demutualization, which resulted in Kentucky Retirement System receiving approximately \$61 million dollars in proceeds. The plaintiffs seek to recover the full amount of the proceeds or, alternatively, the pro rata amount of proceeds attributable to insurance premiums that the employees and/or their beneficiaries paid directly to Anthem. Kentucky Retirement System believes that the claims are without merit and intends to vigorously defend its position. The ultimate outcome of this litigation cannot presently be determined. However, in management's opinion, the likelihood of a material adverse outcome is unlikely. Accordingly, adjustments, if any, that might result from the resolution of this matter have not been reflected in the financial statements.

**NOTE L--EXCHANGE GAIN OR LOSS**

Foreign currency translations resulted in an aggregate exchange gain of \$158,432,007 for the Pension Funds and \$21,586,901 for the Insurance Funds.

**NOTE M--DEFINED BENEFIT PENSION PLAN**

All eligible employees of Kentucky Retirement Systems (KRS) participate in the Kentucky Employees Retirement System (non-hazardous), a cost sharing, multiple employer defined pension plan that covers substantially all regular full-time employees in non-hazardous positions of any Kentucky State Department, Board or Agency directed by Executive Order to participate in the system. The Plan provides for retirement, disability, and death benefits to plan members. Plan benefits are extended to beneficiaries of plan members under certain circumstances. KRS contributed 3.76% of covered payroll for the period July 1, 2002 - December 15, 2002 and 5.89% for the period December 16, 2002 - June 30, 2003. For the year ended June 30, 2002, KRS contributed 5.89% of covered payroll. Plan members were required to contribute 5% of creditable compensation for the plan years ended June 30, 2003 and 2002. Covered payroll was approximately \$8,265,000 and \$7,521,000 for 2003 and 2002, respectively. KRS contributed approximately \$408,000 and \$443,000 for 2003 and 2002, respectively.

**KENTUCKY RETIREMENT SYSTEMS**  
**NOTES TO FINANCIAL STATEMENTS--CONTINUED**  
**June 30, 2003 and 2002**

**NOTE N--EQUIPMENT**

Equipment at June 30, 2003 and 2002 consists of the following:

Equipment, at cost	\$ 3,343,869	\$ 3,179,151
Less accumulated depreciation	<u>(2,332,240)</u>	<u>(1,980,185)</u>
	<u>\$ 1,011,629</u>	<u>\$ 1,198,966</u>

Depreciation expense for the years ended June 30, 2003 and 2002 amounted to \$352,054 and \$329,839, respectively.

**NOTE O--COLLATERALIZATION OF DEPOSITS**

At June 30, 2003, KRS had cash deposits at a financial institution, which totaled approximately \$1,709,000. The balance is insured by the Federal Deposit Insurance Corporation up to \$100,000. The remaining balance of approximately \$1,609,000 was collateralized by securities recorded in KRS's name and held by the financial institution.

## **REQUIRED SUPPLEMENTARY INFORMATION**

**KENTUCKY RETIREMENT SYSTEMS  
REQUIRED SUPPLEMENTARY INFORMATION  
SCHEDULE OF FUNDING PROGRESS**

**KENTUCKY EMPLOYEES RETIREMENT SYSTEM**

	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) Entry Age Normal (b)	Unfunded (Overfunded) AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a % of Covered Payroll ((b-a)/c)
<u>Non-Hazardous</u>						
June 30, 1998	4,356,072,625	3,800,014,746	(556,057,879)	1.146	1,321,004,266	(0.421)
June 30, 1999	5,264,340,397	4,327,622,821	(936,717,576)	1.216	1,330,766,100	(0.704)
June 30, 2000	6,806,675,460	4,876,825,772	(1,929,849,688)	1.396	1,409,504,668	(1.369)
June 30, 2001*	6,844,742,687	5,444,035,294	(1,400,707,393)	1.257	1,505,299,220	(0.931)
June 30, 2002	6,654,084,196	6,026,094,764	(627,989,432)	1.104	1,595,809,458	(0.393)
June 30, 2003**	6,351,318,832	6,520,463,188	169,144,356	0.974	1,658,604,696	0.102
<u>Hazardous</u>						
June 30, 1998	212,214,618	171,735,076	(40,479,542)	1.236	93,130,996	(0.435)
June 30, 1999	259,839,319	204,282,788	(55,556,531)	1.272	103,464,123	(0.537)
June 30, 2000	336,213,464	243,365,557	(92,847,907)	1.382	115,639,439	(0.803)
June 30, 2001*	361,677,475	285,193,761	(76,483,714)	1.268	122,857,992	(0.623)
June 30, 2002	376,384,302	322,069,164	(54,315,138)	1.169	125,275,925	(0.434)
June 30, 2003**	385,925,722	356,879,133	(29,046,589)	1.081	129,088,956	(0.225)

\*Asset valuation method was changed to reflect the amount of investment gain/loss for the current year equally over the current year and the following four years.

\*\*Covered payroll was actuarially computed as opposed to estimated in prior years.

**KENTUCKY RETIREMENT SYSTEMS  
REQUIRED SUPPLEMENTARY INFORMATION  
SCHEDULE OF FUNDING PROGRESS--CONTINUED**

**COUNTY EMPLOYEES RETIREMENT SYSTEM**

	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) Entry Age Normal (b)	Unfunded (Overfunded) AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a % of Covered Payroll ((b-a)/c)
<u>Non-Hazardous</u>						
June 30, 1998	3,346,205,003	2,663,946,276	(682,258,727)	1.256	1,437,594,574	(0.475)
June 30, 1999	4,072,227,435	2,991,420,884	(1,080,806,551)	1.361	1,346,601,939	(0.803)
June 30, 2000	5,284,033,534	3,368,601,134	(1,915,432,400)	1.569	1,452,058,248	(1.319)
June 30, 2001*	5,423,834,549	3,706,282,212	(1,717,552,337)	1.463	1,544,973,296	(1.112)
June 30, 2002	5,397,787,158	4,165,355,149	(1,232,432,009)	1.296	1,663,183,629	(0.741)
June 30, 2003**	5,286,580,047	4,417,597,802	(868,982,245)	1.197	1,796,451,180	(0.484)
<u>Hazardous</u>						
June 30, 1998	927,057,492	865,966,626	(61,090,866)	1.071	236,180,023	(0.257)
June 30, 1999	1,124,651,486	963,711,775	(160,939,711)	1.167	256,201,726	(0.628)
June 30, 2000	1,445,542,794	1,084,553,697	(360,989,097)	1.333	288,575,870	(1.251)
June 30, 2001*	1,486,666,016	1,193,860,442	(292,805,574)	1.245	316,700,304	(0.925)
June 30, 2002	1,485,511,793	1,327,291,273	(158,220,520)	1.119	345,849,277	(0.457)
June 30, 2003**	1,467,004,856	1,499,628,782	32,623,926	0.978	374,700,732	0.087

\*Asset valuation method was changed to reflect the amount of investment gain/loss for the current year equally over the current year and the following four years.

\*\*Covered payroll was actuarially computed as opposed to estimated in prior years.

**KENTUCKY RETIREMENT SYSTEMS  
REQUIRED SUPPLEMENTARY INFORMATION  
SCHEDULE OF FUNDING PROGRESS--CONTINUED**

**STATE POLICE RETIREMENT SYSTEM**

<u>Year Ended</u>	Actuarial Value of Assets <u>(a)</u>	Actuarial Accrued Liability (AAL) Entry Age Normal <u>(b)</u>	Overfunded AAL (UAAL) <u>(b-a)</u>	Funded Ratio <u>(a/b)</u>	Covered Payroll <u>(c)</u>	UAAL as a % of Covered Payroll <u>((b-a)/c)</u>
June 30, 1998	306,318,918	294,427,019	(11,891,899)	1.040	38,727,361	(0.307)
June 30, 1999	357,623,196	314,021,673	(43,601,523)	1.139	40,433,405	(1.078)
June 30, 2000	459,168,574	336,579,763	(122,588,811)	1.364	43,619,383	(2.810)
June 30, 2001*	456,160,709	356,211,860	(99,948,849)	1.281	44,646,678	(2.237)
June 30, 2002	438,955,465	380,790,346	(58,165,119)	1.153	44,314,696	(1.312)
June 30, 2003**	413,063,576	414,881,459	1,817,883	0.996	43,760,832	0.042

\*Asset valuation method was changed to reflect the amount of investment gain/loss for the current year equally over the current year and the following four years.

\*\*Covered payroll was actuarially computed as opposed to estimated in prior years.

**KENTUCKY RETIREMENT SYSTEMS  
REQUIRED SUPPLEMENTARY INFORMATION  
SCHEDULE OF FUNDING PROGRESS--CONTINUED**

**KENTUCKY RETIREMENT SYSTEMS INSURANCE FUND**

KERS <u>Non-Hazardous</u>	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) Entry Age Normal (b)	Overfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a % of Covered Payroll ((b-a)/c)
June 30, 1998	210,105,184	1,242,183,993	1,032,078,809	0.169	1,321,004,266	0.781
June 30, 1999	283,704,887	1,273,364,800	989,659,913	0.223	1,330,766,100	0.743
June 30, 2000	399,560,252	1,457,475,358	1,057,915,106	0.274	1,409,504,668	0.751
June 30, 2001*	449,630,605	1,769,583,098	1,319,952,493	0.254	1,505,299,220	0.877
June 30, 2002	521,250,455	1,907,683,881	1,386,433,426	0.273	1,595,809,458	0.869
June 30, 2003**	553,885,082	2,093,210,321	1,539,325,239	0.265	1,658,604,696	0.928
KERS <u>Hazardous</u>						
June 30, 1998	54,606,786	137,394,162	82,787,376	0.397	93,130,996	0.889
June 30, 1999	74,579,649	149,158,586	74,578,937	0.500	103,464,123	0.721
June 30, 2000	102,212,237	175,167,613	72,955,376	0.584	115,639,439	0.631
June 30, 2001*	119,372,742	214,450,822	95,078,080	0.557	122,857,992	0.774
June 30, 2002	135,874,582	236,819,050	100,944,468	0.574	125,275,925	0.806
June 30, 2003**	151,459,500	283,178,335	131,718,835	0.535	129,088,956	1.020

\*Asset valuation method was changed to reflect the amount of investment gain/loss for the current year equally over the current year and the following four years.

\*\*Covered payroll was actuarially computed as opposed to estimated in prior years.

**KENTUCKY RETIREMENT SYSTEMS  
REQUIRED SUPPLEMENTARY INFORMATION  
SCHEDULE OF FUNDING PROGRESS--CONTINUED**

**KENTUCKY RETIREMENT SYSTEMS INSURANCE FUND**

CERS <u>Non-Hazardous</u>	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) Targeted Rate (b)	Overfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a % of Covered Payroll ((b-a)/c)
June 30, 1998	168,531,296	1,213,339,747	1,044,808,451	0.139	1,437,594,574	0.727
June 30, 1999	231,937,169	1,282,874,286	1,050,937,117	0.180	1,346,601,939	0.780
June 30, 2000	319,642,694	1,466,716,928	1,147,074,234	0.218	1,452,058,248	0.790
June 30, 2001*	371,758,628	1,793,710,768	1,421,952,140	0.207	1,544,973,296	0.920
June 30, 2002	450,497,307	1,977,577,038	1,527,079,731	0.228	1,663,183,629	0.918
June 30, 2003**	520,060,105	2,176,963,259	1,656,903,154	0.239	1,796,451,180	0.922
CERS <u>Hazardous</u>						
June 30, 1998	87,055,079	493,286,363	406,231,284	0.176	236,180,023	1.720
June 30, 1999	114,590,223	518,280,115	403,689,892	0.221	256,201,726	1.576
June 30, 2000	168,657,912	599,936,029	431,278,117	0.281	288,575,870	1.495
June 30, 2001*	197,875,249	721,605,292	523,730,043	0.274	316,700,304	1.654
June 30, 2002	234,683,878	781,184,974	546,501,096	0.301	345,849,279	1.580
June 30, 2003**	269,190,080	935,650,662	666,460,582	0.288	374,700,732	1.779

\*Asset valuation method was changed to reflect the amount of investment gain/loss for the current year equally over the current year and the following four years.

\*\*Covered payroll was actuarially computed as opposed to estimated in prior years.

**KENTUCKY RETIREMENT SYSTEMS  
REQUIRED SUPPLEMENTARY INFORMATION  
SCHEDULE OF FUNDING PROGRESS--CONTINUED**

**KENTUCKY RETIREMENT SYSTEMS INSURANCE FUND**

<u>SPRS</u>	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) Targeted Targeted Rate (b)	Overfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a % of Covered Payroll ((b-a)/c)
June 30, 1998	41,410,500	124,501,076	83,090,576	0.333	38,727,361	2.146
June 30, 1999	53,929,859	125,797,150	71,867,291	0.429	40,433,405	1.777
June 30, 2000	71,711,712	138,867,085	67,155,373	0.516	43,619,383	1.540
June 30, 2001*	79,863,577	158,261,479	78,397,902	0.505	44,646,678	1.756
June 30, 2002	86,867,391	165,445,412	78,578,021	0.525	44,314,696	1.773
June 30, 2003**	90,747,967	184,501,205	93,753,238	0.492	43,760,832	2.142

\*Asset valuation method was changed to reflect the amount of investment gain/loss for the current year equally over the current year and the following four years.

\*\*Covered payroll was actuarially computed as opposed to estimated in prior years.

**KENTUCKY RETIREMENT SYSTEMS  
REQUIRED SUPPLEMENTARY INFORMATION  
SCHEDULE OF EMPLOYER CONTRIBUTIONS**

**KENTUCKY EMPLOYEES RETIREMENT SYSTEM**

**NON-HAZARDOUS**

<u>Year Ended</u>	<u>Annual Required Contributions</u>	<u>Actual Contributions</u>	<u>Percentage Contributed</u>
June 30, 1998	117,437,279	112,082,480	0.954
June 30, 1999	106,860,518	107,514,778	1.006
June 30, 2000	113,183,225	115,055,476	1.017
June 30, 2001	88,662,124	90,356,951	1.019
June 30, 2002	93,993,177	95,672,345	1.018
June 30, 2003	96,957,960	72,932,669	0.752

**HAZARDOUS**

<u>Year Ended</u>	<u>Annual Required Contributions</u>	<u>Actual Contributions</u>	<u>Percentage Contributed</u>
June 30, 1998	16,642,509	15,997,189	0.961
June 30, 1999	19,306,405	19,443,818	1.007
June 30, 2000	21,578,319	21,633,272	1.003
June 30, 2001	23,146,446	23,852,961	1.031
June 30, 2002	23,601,984	23,821,216	1.009
June 30, 2003	24,350,617	23,205,870	0.953

**KENTUCKY RETIREMENT SYSTEMS  
REQUIRED SUPPLEMENTARY INFORMATION  
SCHEDULE OF EMPLOYER CONTRIBUTIONS--CONTINUED**

**COUNTY EMPLOYEES RETIREMENT SYSTEM**

**NON-HAZARDOUS**

<u>Year Ended</u>	<u>Annual Required Contributions</u>	<u>Actual Contributions</u>	<u>Percentage Contributed</u>
June 30, 1998	124,351,931	107,490,256	0.864
June 30, 1999	109,074,757	110,591,016	1.014
June 30, 2000	105,709,840	106,587,217	1.008
June 30, 2001	97,951,307	111,206,820	1.135
June 30, 2002	105,445,842	107,678,891	1.021
June 30, 2003	110,720,684	111,090,537	1.003

**HAZARDOUS**

<u>Year Ended</u>	<u>Annual Required Contributions</u>	<u>Actual Contributions</u>	<u>Percentage Contributed</u>
June 30, 1998	44,142,046	42,297,090	0.958
June 30, 1999	46,526,233	48,290,617	1.037
June 30, 2000	50,645,065	51,739,272	1.022
June 30, 2001	51,558,809	53,132,792	1.031
June 30, 2002	56,304,262	56,785,282	1.009
June 30, 2003	63,422,978	62,149,506	0.980

**KENTUCKY RETIREMENT SYSTEMS  
 REQUIRED SUPPLEMENTARY INFORMATION  
 SCHEDULE OF EMPLOYER CONTRIBUTIONS--CONTINUED**

**STATE POLICE RETIREMENT SYSTEM**

<u>Year Ended</u>	<u>Annual Required Contributions</u>	<u>Actual Contributions</u>	<u>Percentage Contributed</u>
June 30, 1998	10,293,733	9,573,742	0.930
June 30, 1999	9,465,460	9,463,188	0.999
June 30, 2000	10,211,298	10,215,824	1.000
June 30, 2001	9,634,753	9,628,912	0.999
June 30, 2002	9,563,111	9,562,256	0.999
June 30, 2003	9,398,296	7,634,252	0.812

**KENTUCKY RETIREMENT SYSTEMS  
REQUIRED SUPPLEMENTARY INFORMATION  
SCHEDULE OF EMPLOYER CONTRIBUTIONS--CONTINUED**

**KENTUCKY RETIREMENT SYSTEMS INSURANCE FUND**

**KERS  
NON-HAZARDOUS**

<u>Year Ended</u>	<u>Annual Required Contributions</u>	<u>Actual Contributions</u>	<u>Percentage Contributed</u>
June 30, 1998	54,029,074	39,503,545	0.731
June 30, 1999	56,690,636	56,769,539	1.001
June 30, 2000	76,818,004	76,926,320	1.001
June 30, 2001	66,874,871	66,874,871	1.000
June 30, 2002	93,993,177	93,912,017	0.999
June 30, 2003	92,052,561	65,335,219	0.710

**KERS  
HAZARDOUS**

<u>Year Ended</u>	<u>Annual Required Contributions</u>	<u>Actual Contributions</u>	<u>Percentage Contributed</u>
June 30, 1998	9,341,039	6,632,037	0.710
June 30, 1999	10,760,269	10,773,916	1.001
June 30, 2000	12,026,502	12,047,095	1.002
June 30, 2001	13,226,298	13,226,298	1.000
June 30, 2002	15,859,932	15,887,399	1.002
June 30, 2003	15,839,215	15,883,263	1.003

**KENTUCKY RETIREMENT SYSTEMS  
REQUIRED SUPPLEMENTARY INFORMATION  
SCHEDULE OF EMPLOYER CONTRIBUTIONS--CONTINUED**

**KENTUCKY RETIREMENT SYSTEMS INSURANCE FUND**

**CERS  
NON-HAZARDOUS**

<u>Year Ended</u>	<u>Annual Required Contributions</u>	<u>Actual Contributions</u>	<u>Percentage Contributed</u>
June 30, 1998	48,303,178	29,271,074	0.606
June 30, 1999	47,939,029	47,901,837	0.999
June 30, 2000	55,033,008	55,213,973	1.003
June 30, 2001	62,292,385	62,292,385	1.000
June 30, 2002	102,119,475	102,150,543	1.000
June 30, 2003	102,038,427	99,234,843	0.973

**CERS  
HAZARDOUS**

<u>Year Ended</u>	<u>Annual Required Contributions</u>	<u>Actual Contributions</u>	<u>Percentage Contributed</u>
June 30, 1998	20,783,842	14,275,040	0.687
June 30, 1999	23,647,419	23,382,957	0.989
June 30, 2000	27,991,859	28,345,377	1.013
June 30, 2001	32,149,432	32,149,432	1.000
June 30, 2002	45,721,274	45,730,333	1.000
June 30, 2003	43,502,755	45,243,950	1.040

**KENTUCKY RETIREMENT SYSTEMS  
REQUIRED SUPPLEMENTARY INFORMATION  
SCHEDULE OF EMPLOYER CONTRIBUTIONS--CONTINUED**

**KENTUCKY RETIREMENT SYSTEMS INSURANCE FUND**

**SPRS**

<u>Year Ended</u>	<u>Annual Required Contributions</u>	<u>Actual Contributions</u>	<u>Percentage Contributed</u>
June 30, 1998	5,909,401	5,125,678	0.867
June 30, 1999	6,808,270	5,120,037	0.752
June 30, 2000	7,237,579	7,251,787	1.002
June 30, 2001	7,807,870	7,817,613	1.001
June 30, 2002	8,098,907	8,113,391	1.002
June 30, 2003	9,443,588	7,654,313	0.811

**KENTUCKY RETIREMENT SYSTEMS  
NOTES TO REQUIRED SUPPLEMENTARY INFORMATION**

The information presented in the required supplementary schedules was determined as part of the actuarial valuations at the dates indicated. Additional information as of the latest actuarial valuation follows:

**PENSION FUNDS**

	<u>Non-Hazardous</u>	<u>Hazardous</u>
Valuation Date	June 30, 2003	June 30, 2003
Actuarial Cost Method	Entry Age Normal	Entry Age Normal
Amortization Method	Level Percent Closed	Level Percent Closed
Amortization Period - Each Benefit Improvement	30 years – Commencing with 1990 Valuation	30 years – Commencing with 1990 Valuation
Asset Valuation Method	Five-year Smoothing of Investment Gains and Losses	Five-year Smoothing of Investment Gains and Losses
Postretirement Benefit Increase	2.85%	2.85%
Actuarial Assumptions:		
Investment Return	8.25%	8.25%
Projected Salary Increases	6.50%	6.50%
Inflation Rate	3.50%	3.50%

**POST-EMPLOYMENT HEALTHCARE**

	<u>Non-Hazardous</u>	<u>Hazardous</u>
Valuation Date	June 30, 2003	June 30, 2003
Actuarial Cost Method	Targeted Rate	Targeted Rate
Asset Valuation Method - Started with 1996 Valuation	Five-year Smoothing of Investment Gains and Losses	Five-year Smoothing of Investment Gains and Losses
Actuarial Assumptions:		
Investment Return	8.25%	8.25%
Projected Salary Increases	6.50%	6.50%
Inflation Rate	3.50%	3.50%

**Kentucky Retirement Systems**  
*June 30, 2003 Comprehensive Annual Financial Report*

**ADDITIONAL SUPPORTING SCHEDULES**

**KENTUCKY RETIREMENT SYSTEMS**  
**SCHEDULE OF ADMINISTRATIVE EXPENSES**  
**Years Ended June 30, 2003 and 2002**  
(Dollars in thousands)

	<u>2003</u>	<u>2002</u>
<b>Personal Services</b>		
Salaries and per diem	\$ 8,681	\$ 7,702
Fringe benefits	1,679	1,574
Tuition assistance	<u>45</u>	<u>36</u>
<b>Total personal services</b>	10,405	9,312
<b>Contractual Services</b>		
Actuarial	66	36
Audit	59	28
Legal	575	246
Medical	211	139
Contractual	<u>452</u>	<u>348</u>
<b>Total contractual services</b>	1,363	797
<b>Communication</b>		
Printing	142	143
Telephone	134	121
Postage	337	685
Travel	<u>168</u>	<u>135</u>
<b>Total communication</b>	781	1,084
<b>Rentals</b>		
Office space	814	512
Equipment	<u>52</u>	<u>43</u>
<b>Total rentals</b>	866	555
<b>Miscellaneous</b>		
Utilities	101	66
Supplies	123	177
Insurance	48	36
Maintenance	225	199
Other	<u>166</u>	<u>47</u>
<b>Total miscellaneous</b>	663	525
<b>Depreciation</b>	352	330
<b>Healthcare Administrative Fees</b>	<u>862</u>	<u>778</u>
<b>Total Administrative Expenses</b>	<u>\$ 15,292</u>	<u>\$ 13,381</u>

**KENTUCKY RETIREMENT SYSTEMS**  
**SCHEDULE OF INVESTMENT EXPENSES**  
**Years Ended June 30, 2003 and 2002**  
(Dollars in thousands)

	<u>2003</u>	<u>2002</u>
<b>RETIREMENT FUNDS</b>		
<b>Security Lending Fees</b>		
Broker rebates	\$ 29,191	\$ 47,021
Lending agent fees	<u>1,554</u>	<u>2,964</u>
<b>Total security lending</b>	30,745	49,985
<b>Common Stock Commissions</b>	3,101	3,990
<b>Contractual Services</b>		
Investment management	6,609	6,704
Security custody	591	461
Investment consultant	<u>185</u>	<u>130</u>
<b>Total contractual services</b>	7,385	7,295
<b>INSURANCE FUNDS</b>		
<b>Security Lending Fees</b>		
Broker rebates	2,286	3,325
Lending agent fees	<u>140</u>	<u>186</u>
<b>Total security lending</b>	2,426	3,511
<b>Common Stock Commissions</b>	378	430
<b>Investment Management</b>	<u>522</u>	<u>451</u>
<b>Total investment expenses</b>	<u>\$ 44,557</u>	<u>\$ 65,662</u>

Information on fees paid to investment professionals can be found in the Investment Section of the Comprehensive Annual Financial Report.

**KENTUCKY RETIREMENT SYSTEMS**  
**SCHEDULE OF PROFESSIONAL CONSULTANT FEES**  
**Years Ended June 30, 2003 and 2002**  
(Dollars in thousands)

	<u>2003</u>	<u>2002</u>
Actuarial Services	\$ 66	\$ 36
Medical Review Services	211	139
Audit Services	59	28
Legal Counsel	<u>575</u>	<u>246</u>
Total	<u>\$ 911</u>	<u>\$ 449</u>

# KENTUCKY RETIREMENT SYSTEMS

## **Investment Section**

*Comprehensive Annual Financial Report*  
June 30, 2003

# **INVESTMENT SECTION PREFACE**

**June 30, 2003 Comprehensive Annual Financial Report**

The Board of Trustees is charged with the responsibility of investing the systems' assets to provide for the benefits of the members of the systems. To achieve that goal the Board follows a policy of preserving capital, while seeking means of enhancing revenues and protecting against undue losses in any particular investment area.

The Board recognizes its fiduciary duty not only to invest the funds in formal compliance with the Prudent Person Rule, but also to manage the funds in continued recognition of the basic long term nature of the systems. In order to maintain quality while maximizing the long-range return, the Board diversifies the investment of the assets among classes of securities.

The assets are managed by the Investment Division staff and by external professional managers based on these investment policies:

## **Objectives**

**Long-Term:** The total assets of the systems should achieve a return measured over two market cycles (estimated to be six to ten years) which exceeds the rate of inflation for the period, as measured by the Consumer Price Index for All Urban Consumers, by at least 4%.

**Short-Term:** The returns of the particular asset classes of the managed funds of the systems, measured on a year-to-year basis, should exceed the returns achieved by comparable unmanaged market indices.

In keeping with its responsibility as trustee and wherever consistent with its fiduciary responsibility, the Board encourages the investment of the systems' assets in securities of corporations that provide a positive contribution to the economy of the Commonwealth of Kentucky.

## **Investments Performance Review Procedures**

At least once each quarter, the Investment Committee, on behalf of the Board of Trustees, reviews the performance of the portfolio for determination of compliance with the Statement of Investment Policy. Each month the Investment Division performs tests to assure compliance with the restrictions imposed by the Investment Policy.

## **Investment Consulting**

The Board employs Mercer Investment Consulting, Inc. to review the asset allocation guidelines and the performance of both the internally managed and externally managed assets. A letter from that firm follows this introduction and discusses current allocations, performance and significant changes over the fiscal year.

# MERCER

Investment Consulting

10 South Wacker Drive, Suite 1700  
Chicago, IL 60606-7500  
312 902 7500 Fax 312 902 7626  
www.mercerIc.com

15 August 2003

The Board of Trustees of the Kentucky Retirement Systems  
Perimeter Park West  
1260 Louisville Road  
Frankfort, KY 40601

Subject:  
**Annual Fund Review**

Dear Trustees:

Mercer is charged with the duty to advise the Board in its asset management activities. This is our annual review of the asset management of the Kentucky Retirement Systems (KRS). Although we recognize that the Board of Trustees is charged with the responsibility of managing the Funds in a manner consistent with the basic long term nature of the participating systems, our comments focus on the annual period ended June 30, 2003. In managing the Funds, the Board must maintain formal compliance with the Prudent Person Rule. Therefore, it seeks to maintain proper and appropriate diversification for the Fund.

## **Market Highlights**

The twelve months ending June 30, 2003 was turbulent for investors globally. Equity markets continued to decline well into the latter half of 2002. Markets rallied in October and November, but the perceived economic recovery was not sustainable, and equities slumped again during the last month of 2002 and into 2003. In March 2003, equity markets slowly began adding value as the military campaign in Iraq transitioned into an occupation and rebuilding phase. For the trailing year, the S&P 500 Index returned 0.3%. Fixed Income, as measured by the Lehman Brothers Aggregate Index, returned 10.4% over the same period, benefiting from struggling equities and the declining interest rate environment.

## **Systems Highlights**

According to the FundAnalytics statements from Northern Trust, the System's assets expanded back to their June 2002 level of \$10.9 billion by June 30, 2003 due mainly to investment appreciation during the fourth quarter of 2002 and the second quarter of 2003. Over the trailing



# MERCER

Investment Consulting

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15 August 2003

The Board of Trustees of the Kentucky Retirement Systems

year, the Fund returned 4.3%. Performance trailed the Reference Index return of 4.7%. The Insurance Fund was valued at \$1.3 billion, a \$0.1 billion increase since June 30, 2002. The Fund posted a 1.7% gain over the trailing twelve month period, outpacing its Reference Index return of -0.6%. Both Funds achieved positive absolute performance at a risk or volatility level lower than those of their respective Reference Indices. The Reference Indices are constructed according to the individual target asset allocations of the Funds.

Allocations to domestic and international equities were below Target in both the Retirement and Insurance Funds, while cash was above target for both plans as of June 30, 2003. Fixed Income for the Retirement Fund exceeded Target.

Asset allocation as of June 30th for the Retirement and Insurance Funds are compared in the table below to their individual asset allocation targets:

<u>Asset Classes</u>	<u>Retirement Fund</u>		<u>Insurance Fund</u>	
	Actual Allocation 06/30/03	Target Asset Allocation	Actual Allocation 06/30/03	Target Asset Allocation
Domestic Equity	38.2	40.0	55.3	60.0
International Equity	12.5	15.0	18.9	20.0
Fixed Income	28.6	27.0	0.0	0.0
Alternatives *	4.4	5.0	4.8	5.0
TIPS	10.9	10.0	10.2	10.0
Cash	5.4	3.0	10.8	5.0

\* Includes Real Estate and Private Equity.

It is our understanding that the high allocation to cash within the Insurance Fund includes funds received as a result of a demutualization of Anthem Insurance Companies, Inc. The funds are currently held in trust on behalf of multiple retirement plans (including plans not associated with

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The Board of Trustees of the Kentucky Retirement Systems

KRS) as cash equivalents pending the outcome of litigation. These funds comprise approximately 4.7% of the 10.8% allocation to cash as of June 30, 2003.

Other than the cash portion of the Insurance Fund, all major asset classes are within their allowable ranges. As detailed in the current Investment Policy for the Plans, "The Staff at KRS shall reallocate the assets when actual asset class allocation is within 1.0% of the allowable range boundary, but may reallocate when the actual class allocation exceeds the target asset class by a margin of +/- 5.0%." In addition, four out of the five Plans are currently facing negative cash flows, due in part to market conditions and the receipt of less employer contributions than recommended by the actuary. Therefore, KRS has opportunistically retained a somewhat higher cash position in order to meet the monthly obligations of the Plans.

### **Investment Manager Highlights**

#### **The Retirement Fund**

NAMCO and AllianceBernstein lagged their respective indices over the trailing year ending June 30. The Core Equity manager, NAMCO returned -6.7%, underperforming the S&P 500 Index return of 0.3% over the same period. AllianceBernstein returned 0.4% while the S&P Growth Index returned 2.3%.

As we discussed during the Board meeting in late July, Mercer continues to be concerned with the performance of the AllianceBernstein product on both a relative and risk adjusted basis. In addition, representatives from Mercer Investment Consulting and Kentucky Retirement Systems had an on-site due diligence meeting with AllianceBernstein in mid July to discuss their lackluster performance. It was agreed by the committee that we would review the product after the third and fourth quarter of 2003 to determine its ongoing feasibility in the Plan.

Bank of Ireland trailed and Fidelity outpaced the International Equity Blended Index loss of 6.4% over the past year. Bank of Ireland returned -9.5% and Fidelity returned -4.0%.

The Weaver Barksdale Core portfolio and NAMCO both returned 12.9%, trailing the Fixed Income Blended Index return of 13.2%. However, the Weaver Barksdale TIPS strategy (15.5%)

# MERCER

Investment Consulting

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15 August 2003

The Board of Trustees of the Kentucky Retirement Systems

outpaced the LB TIPS Index by 10 basis points. Lincoln Capital returned 11.1%, outpacing the LB Aggregate return of 10.4%. The Fixed Income composite gained 13.0% over the trailing year, 20 basis points short of its Index.

## The Insurance Fund

The NAMCO TIPS gained 15.4%, performing in line with the LB US Tips Index. Fidelity exceeded the MSCI EAFE Index return of -6.1%, returning -4.0% during the year.

## Summary

Many of the Fund's strategies struggled in comparison to their indices over the trailing year. However, with the exception of AllianceBernstein, Mercer believes this short term underperformance is a result of a difficult investment environment, and not indicative of active management's inability to add value over longer periods. Both Funds have experienced an expansion of their investment assets over past year due to absolute positive performance from the fixed income managers.

Sincerely,



Douglas J. Kryscio  
312.902.7147

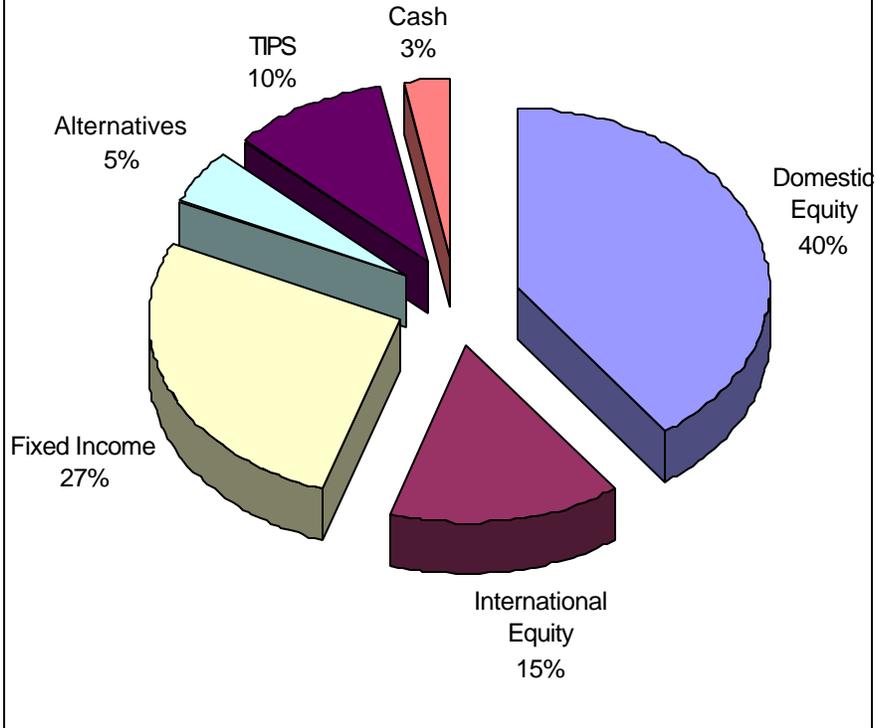
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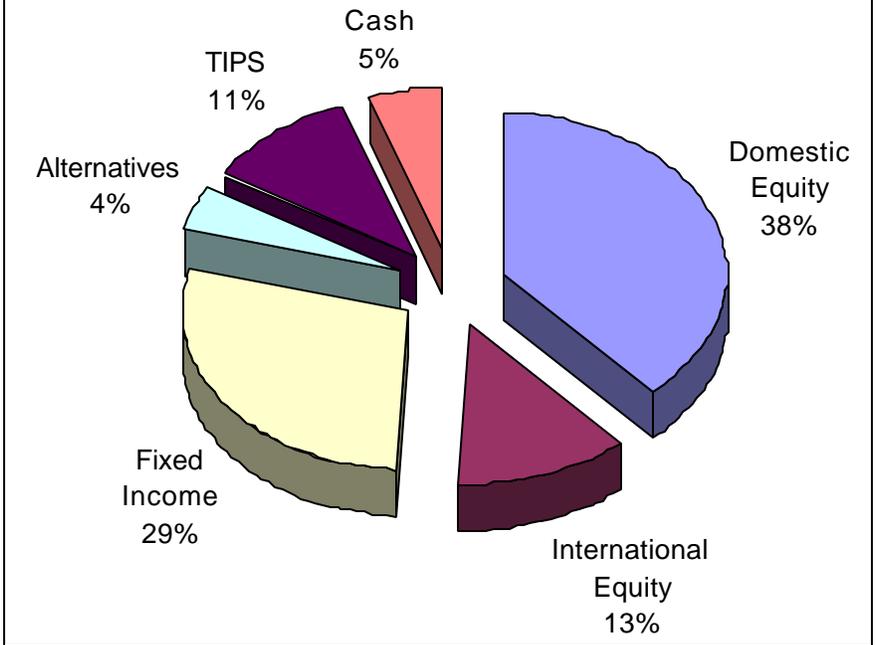
B. Aldridge, Kentucky Retirement Systems

R. Leggett, Kentucky Retirement Systems

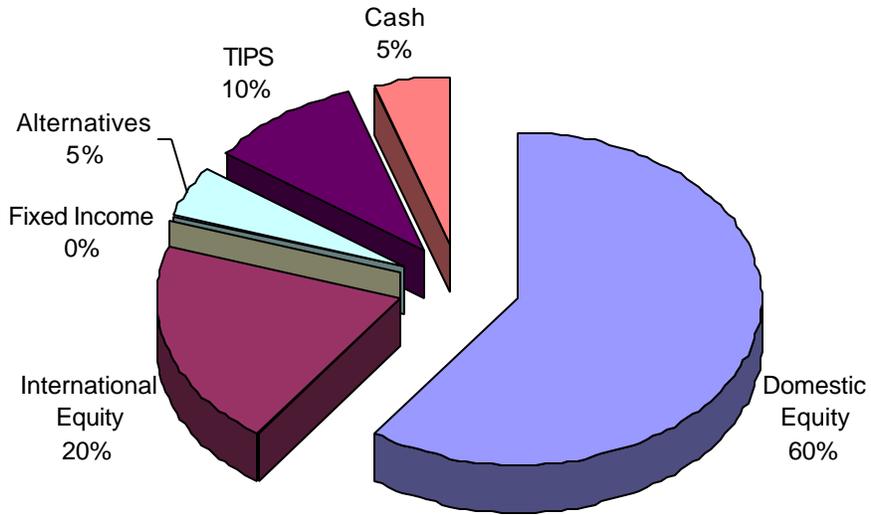
### Pension Fund Target Allocation



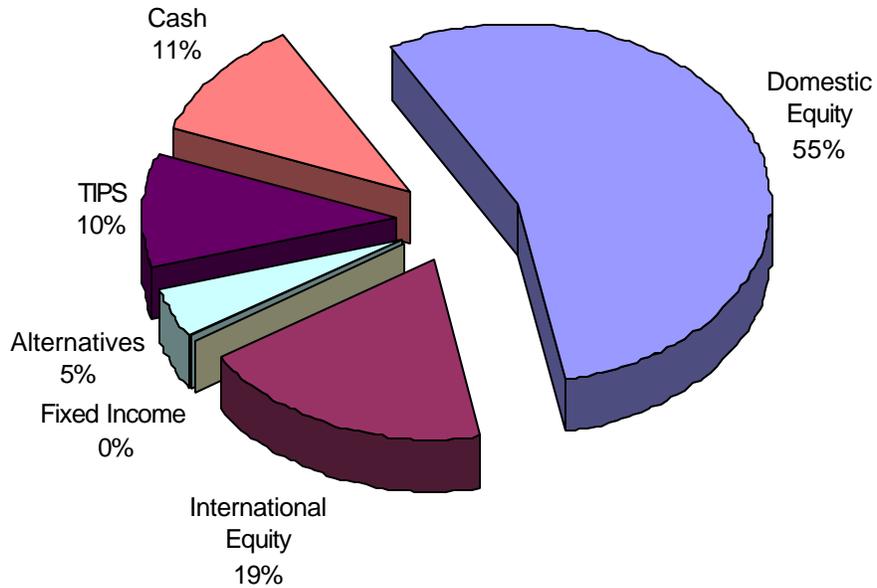
### Pension Fund Actual Allocation (June 30, 2003)



### Insurance Fund Target Allocation



### Insurance Fund Actual Allocation (June 30, 2003)



**KENTUCKY RETIREMENT SYSTEMS**

**PERFORMANCE EVALUATION**

**PENSION FUNDS**

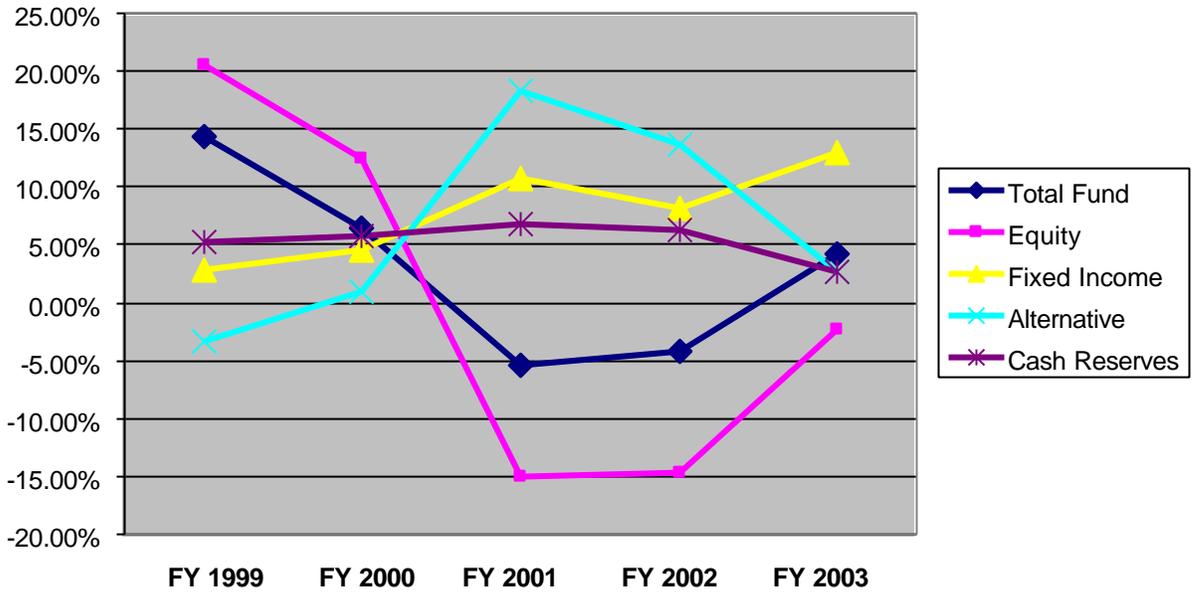
	<b>Fiscal Year</b>	<b>3-Year</b>	<b>5-Year</b>
<b>Total KRS Retirement Fund</b>	<b>4.28%</b>	<b>(1.90%)</b>	<b>2.80%</b>
KRS Blended Index	4.70%	(2.69%)	2.68%
CPI	2.11%	2.14%	2.43%
<b>KRS Equities</b>	<b>(2.25%)</b>	<b>(10.88%)</b>	<b>(0.85%)</b>
KRS Blended Index	(3.25%)	(11.32%)	(1.94%)
S&P 1500	(1.68%)	(11.29%)	(2.24%)
<b>KRS Fixed Income</b>	<b>13.03%</b>	<b>10.63%</b>	<b>7.80%</b>
KRS Blended Index	13.25%	10.79%	7.94%
Lehman Bros. Govt./Credit Bond Index	13.15%	10.82%	7.83%
<b>KRS Alternate Investments</b>	<b>2.71%</b>	<b>10.80%</b>	<b>11.96%</b>
KRS Blended Index	7.87%	N/A	N/A
<b>KRS Cash Reserves</b>	<b>2.71%</b>	<b>5.25%</b>	<b>5.36%</b>
Salomon Bros. 3 Month T-Bill	1.42%	3.15%	3.89%

**INSURANCE FUNDS**

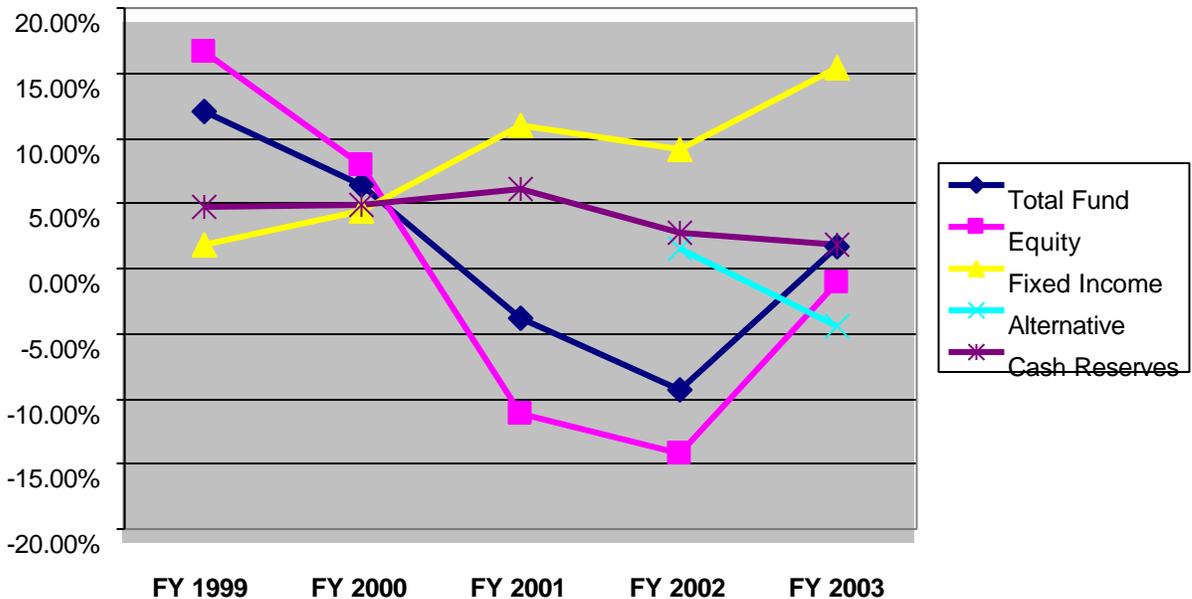
	<b>Fiscal Year</b>	<b>3-Year</b>	<b>5-Year</b>
<b>Total KRS Insurance Fund</b>	<b>1.67%</b>	<b>(3.92%)</b>	<b>1.14%</b>
KRS Blended Index	(0.07%)	(6.05%)	0.11%
CPI	2.11%	2.14%	2.43%
<b>KRS Insurance Fund Equities</b>	<b>(1.06%)</b>	<b>(8.98%)</b>	<b>(1.08%)</b>
KRS Blended Index	(2.82%)	(10.04%)	(1.71%)
S&P 1500	(1.68%)	(11.29%)	(2.24%)
<b>KRS Insurance Fund Fixed Income</b>	<b>15.44%</b>	<b>11.83%</b>	<b>8.28%</b>
KRS Blended Index	15.40%	11.78%	8.53%
<b>KRS Alternate Investments</b>	<b>(4.41%)</b>	<b>N/A</b>	<b>N/A</b>
KRS Blended Index	7.87%	N/A	N/A
<b>KRS Insurance Fund Cash Reserves</b>	<b>1.89%</b>	<b>3.57%</b>	<b>4.05%</b>
Salomon Bros. 3 Month T-Bill	1.42%	3.15%	3.89%

The calculations made by the custody bank in the Performance Evaluation were prepared using a time-weighted rate of return based on the market rate of return in accordance with AIMR's performance presentation standards.

**Time-Weighted Annual Returns by Asset Class  
(Retirement Funds)**



**Time-Weighted Annual Returns by Asset Class  
(Insurance Funds)**



**KENTUCKY RETIREMENT SYSTEMS**

**PORTFOLIO SUMMARIES**

**JUNE 30, 2003**

CLASS	KERS NON HAZARDOUS June 30, 2002		KERS NON HAZARDOUS June 30, 2003		% OF MKT VALUE June 30, 2003
	BOOK VALUE	MARKET VALUE	BOOK VALUE	MARKET VALUE	
<b>Bonds</b>	\$1,655,696,978	\$1,695,471,995	\$1,629,793,345	\$1,772,036,808	36%
<b>Mortgages</b>	288,952,763	295,890,402	255,486,658	257,880,947	5%
<b>Short-term</b>	248,598,556	248,312,086	152,592,087	153,247,067	3%
<b>Alternative</b>	233,684,658	264,290,493	189,254,761	208,630,080	4%
<b>Domestic Equities</b>	1,727,868,664	1,836,522,403	1,769,418,597	1,905,665,342	39%
<b>International Equities</b>	699,326,570	610,952,182	664,134,948	578,899,308	12%
<b>Total Portfolio</b>	4,854,128,189	4,951,439,561	4,660,680,396	4,876,359,552	100%

CLASS	KERS HAZARDOUS June 30, 2002		KERS HAZARDOUS June 30, 2003		% OF MKT VALUE June 30, 2003
	BOOK VALUE	MARKET VALUE	BOOK VALUE	MARKET VALUE	
<b>Bonds</b>	\$97,076,457	\$99,477,370	\$96,359,797	\$104,852,057	33%
<b>Mortgages</b>	17,039,177	17,448,664	15,092,421	15,234,599	5%
<b>Short-term</b>	25,025,444	25,013,660	18,127,073	18,195,842	6%
<b>Alternative</b>	17,540,921	20,103,716	15,038,791	16,881,363	5%
<b>Domestic Equities</b>	88,802,009	95,650,025	114,803,820	123,778,198	39%
<b>International Equities</b>	44,878,983	39,544,121	42,369,173	37,138,867	12%
<b>Total Portfolio</b>	290,362,991	297,237,556	301,791,075	316,080,926	100%

For these portfolio summaries, market value is equivalent to fair value. A summary of acceptable types of investments by class is contained in Note D to the financial statements in the Financial Section.

**KENTUCKY RETIREMENT SYSTEMS**

**PORTFOLIO SUMMARIES**

**JUNE 30, 2003**

CLASS	CERS NON HAZARDOUS June 30, 2002		CERS NON HAZARDOUS June 30, 2003		% OF MKT VALUE June 30, 2003
	BOOK VALUE	MARKET VALUE	BOOK VALUE	MARKET VALUE	
<b>Bonds</b>	\$1,357,524,236	\$1,389,803,226	\$1,336,817,229	\$1,452,706,088	35%
<b>Mortgages</b>	236,988,210	242,676,529	209,533,366	211,499,185	5%
<b>Short-term</b>	221,102,196	220,811,905	237,857,390	238,769,081	6%
<b>Alternative</b>	190,774,472	217,511,238	156,137,460	174,249,104	4%
<b>Domestic Equities</b>	1,366,334,749	1,454,440,727	1,425,109,433	1,540,452,440	37%
<b>International Equities</b>	630,731,420	556,996,550	587,804,057	516,056,612	13%
<b>Total Portfolio</b>	4,003,455,283	4,082,240,175	3,953,258,935	4,133,732,510	100%

CLASS	CERS HAZARDOUS June 30, 2002		CERS HAZARDOUS June 30, 2003		% OF MKT VALUE June 30, 2003
	BOOK VALUE	MARKET VALUE	BOOK VALUE	MARKET VALUE	
<b>Bonds</b>	\$372,939,799	\$381,820,100	\$367,125,344	\$398,906,715	35%
<b>Mortgages</b>	65,447,544	67,018,947	57,877,613	58,421,019	5%
<b>Short-term</b>	63,380,898	63,305,223	68,352,052	68,612,892	6%
<b>Alternative</b>	55,688,648	63,547,845	45,925,862	51,356,064	4%
<b>Domestic Equities</b>	377,645,550	401,695,881	401,723,792	435,940,054	38%
<b>International Equities</b>	169,672,542	149,322,781	160,151,494	140,162,485	12%
<b>Total Portfolio</b>	1,104,774,981	1,126,710,777	1,101,156,157	1,153,399,229	100%

For these portfolio summaries, market value is equivalent to fair value. A summary of acceptable types of investments by class is contained in Note D to the financial statements in the Financial Section.

**KENTUCKY RETIREMENT SYSTEMS**

**PORTFOLIO SUMMARIES**

*JUNE 30, 2003*

CLASS	STATE POLICE RETIREMENT SYSTEM June 30, 2002		STATE POLICE RETIREMENT SYSTEM June 30, 2003		% OF MKT VALUE June 30, 2003
	BOOK VALUE	MARKET VALUE	BOOK VALUE	MARKET VALUE	
<b>Bonds</b>	\$111,429,852	\$114,102,622	\$107,345,666	\$116,788,407	37%
<b>Mortgages</b>	19,028,354	19,484,961	16,812,317	16,969,831	5%
<b>Short-term</b>	19,119,472	19,109,111	8,382,400	8,420,116	3%
<b>Alternative</b>	16,430,587	18,498,935	13,614,664	14,895,530	5%
<b>Domestic Equities</b>	110,503,695	118,712,335	114,041,105	123,749,125	39%
<b>International Equities</b>	41,563,007	35,740,738	41,228,892	35,602,808	11%
<b>Total Portfolio</b>	318,074,967	325,648,702	301,425,044	316,425,817	100%

CLASS	INSURANCE FUND June 30, 2002		INSURANCE FUND June 30, 2003		% OF MKT VALUE June 30, 2003
	BOOK VALUE	MARKET VALUE	BOOK VALUE	MARKET VALUE	
<b>Bonds</b>	\$114,752,500	\$119,766,192	\$116,320,111	\$133,240,710	10%
<b>Mortgages</b>	0	0	0	0	0%
<b>Short-term</b>	166,641,837	166,948,096	146,217,293	147,225,515	11%
<b>Alternative</b>	45,048,991	44,419,406	65,505,381	63,811,861	5%
<b>Domestic Equities</b>	624,558,167	620,216,949	727,982,011	731,807,786	55%
<b>International Equities</b>	236,828,693	216,626,368	252,580,159	243,746,926	19%
<b>Total Portfolio</b>	1,187,830,188	1,167,977,011	1,308,604,955	1,319,832,798	100%

For these portfolio summaries, market value is equivalent to fair value. A summary of acceptable types of investments by class is contained in Note D to the financial statements in the Financial Section.

## List of Largest Assets Held

*Pension Fund*

### Largest Stock Holdings

*(By Market Value)*

**June 30, 2003**

<u>Rank</u>	<u>Shares</u>	<u>Stock</u>	<u>Market Value</u>
1	4,082,780	MICROSOFT CORP	104,553,038.18
2	2,925,650	PFIZER INC	99,910,947.50
3	3,445,840	GENERAL ELECTRIC CO	98,826,691.20
4	2,163,406	CITIGROUP INC	92,593,776.80
5	1,626,760	WAL MART	87,308,209.20
6	1,985,794	EXXON MOBIL CORP	71,309,862.54
7	1,362,234	JOHNSON & JOHNSON	70,427,497.80
8	1,121,747	AMERICAN INTERNATIONAL	61,897,999.46
9	3,435,820	CISCO SYS INC	57,343,835.80
10	2,757,418	INTEL CORP COM	<u>57,310,175.71</u>
<b>TOTAL</b>			<b>801,482,034.19</b>

### Largest Bond Holdings

*(By Market Value)*

**June 30, 2003**

<u>Rank</u>	<u>Par</u>	<u>Bonds</u>	<u>Market Value</u>
1	131,500,000.00	US TSY BDS INFL INDEX 3.875 DUE 4/15/29	187,192,782.69
2	109,000,000.00	US TSY BDS INFL INDEX 3.625 DUE 4/15/28	150,663,248.76
3	118,000,000.00	US TSY NTS INFL INDEX 3.625 DUE 1/15/08	150,536,827.94
4	108,000,000.00	US TSY NTS INFL INDEX 3.375 DUE 1/15/07	137,476,978.92
5	104,000,000.00	US TSY BDS INFL INDEX 3.875 DUE 1/15/09	133,356,775.76
6	96,200,000.00	US TSY NTS INFL INDEX 3.000 DUE 7/15/12	108,304,836.37
7	74,000,000.00	US TSY NTS INFL INDEX 4.54189 DUE 1/15/10	95,096,542.34
8	75,000,000.00	US TSY NTS INFL INDEX 3.500 DUE 1/15/11	89,926,968.00
9	68,390,000.00	U S TSY NTS 7.000 DUE 07/15/06 Rating AAA	79,049,947.93
10	63,750,000.00	US TSY NTS 5.875 DUE 11/15/04 Rating AAA	<u>67,859,329.46</u>
<b>TOTAL</b>			<b>1,199,464,238.17</b>

A complete list of portfolio holdings is available upon request.

## List of Largest Assets Held

*Insurance Fund*

### Largest Stock Holdings

*(By Market Value)*  
June 30, 2003

<u>Rank</u>	<u>Shares</u>	<u>Stock</u>	<u>Market Value</u>
1	621,500	GENERAL ELECTRIC CO	17,824,620.00
2	646,000	MICROSOFT CORP	16,544,060.00
3	477,000	PFIZER INC	16,289,550.00
4	420,300	EXXON CORP	15,092,973.00
5	265,300	WAL MART STORES INC	14,238,651.00
6	320,800	CITIGROUP INC	13,730,240.00
7	177,488	JOHNSON & JOHNSON	9,176,129.60
8	413,800	INTEL CORP COM	8,600,419.20
9	155,684	AMER INTL GROUP	8,590,643.12
10	101,100	COCA COLA CO	<u>8,340,750.00</u>
<b>TOTAL</b>			<b>128,428,035.92</b>

### Largest Bond Holdings

*(By Market Value)*  
June 30, 2003

<u>Rank</u>	<u>Par</u>	<u>Bonds</u>	<u>Market Value</u>
1	15,600,000.00	U S TSY INFLATION INDEX 3.875 DUE 04/15/29	22,206,900.45
2	18,300,000.00	U S TSY INFLATION INDEX 3.000 DUE 07/15/12	20,602,687.17
3	12,400,000.00	U S TSY INFLATION INDEX 3.625 DUE 04/15/28	17,139,672.33
4	13,300,000.00	U S TSY INFLATION INDEX 3.625 DUE 01/15/08	16,967,286.53
5	12,300,000.00	U S TSY INFLATION INDEX 3.875 DUE 01/15/09	15,772,003.28
6	11,700,000.00	U S TSY INFLATION INDEX 3.375 DUE 01/15/07	14,893,339.38
7	7,450,000.00	U S TSY INFLATION INDEX 4.55189 DUE 01/15/10	9,573,908.65
8	5,300,000.00	U S TSY INFLATION INDEX 3.61574 DUE 01/15/11	6,354,839.07
9	5,000,000.00	U S TSY INFLATION INDEX 3.375 DUE 01/15/12	5,853,675.95
10	3,100,000.00	U S TSY INFLATION INDEX 3.375 DUE 04/15/32	<u>3,876,397.41</u>
<b>TOTAL</b>			<b>133,240,710.22</b>

A complete list of portfolio holdings is available upon request.

## Schedule of Fees and Commissions

*Year Ended June 30, 2003*

External Investment Manager Fees	
<b>Equities and Fixed Income</b>	
Pension Funds	\$6,609,494
Insurance Funds	521,854
<b>Investment Consulting Fees</b>	184,490
<b>Security Lending Agent Fees</b>	33,171,032
<b>Brokerage Commissions — Equities</b>	<u>3,479,424</u>
<b>TOTAL</b>	<b>43,966,294</b>

Total fees and commissions represent .103% of the fair value of the combined Pension and Insurance Fund portfolios (excluding securities lending broker rebates).

## INVESTMENT MANAGERS

Alliance Capital Management	Lincoln Capital Management Company
C. B. Richard Ellis	Invesco-National Asset Management Corp.
Heitman Capital Management Corp.	Northern Trust Quantitative Advisors, Inc.
Weaver C. Barksdale & Associates, Inc.	Bank of Ireland Asset Management
Lend Lease	Fidelity Management Trust Company
J.W. Childs Associates L.P.	Vantage Point Venture Partners L.P.

KENTUCKY RETIREMENT SYSTEMS

# **Actuarial Section**

*Comprehensive Annual Financial Report  
June 30, 2003*



THE SEGAL COMPANY

2018 Powers Ferry Road, Suite 850 Atlanta, GA 30339  
T 678.306.3100 F 678.306.3190 www.segalco.com

November 18, 2003

Board of Trustees  
Kentucky Retirement Systems  
Perimeter Park West  
1260 Louisville Road  
Frankfort, Kentucky 40601

Members of the Board:

The forty-seventh annual actuarial valuation of the Kentucky Employees Retirement System, the forty-fourth annual actuarial valuation of the County Employees Retirement System, and the forty-fifth annual actuarial valuation of the State Police Retirement System have been completed and the reports prepared. The following comments are pertinent to the results of this valuation:

1. The funding objectives for the plan remain unchanged from the prior year's valuation. Relative to the retirement fund, a contribution rate has been established which consists of the normal cost and amortization payment on the unfunded actuarial accrued liability. The normal cost is expected to remain level as a percent of payroll in future years. The amortization of any unfunded actuarial accrued liability is made over 30 years from the establishment of the amortization base using a level percent of payroll amortization method. Each year any actuarial gains or losses, along with any other changes in the accrued liability (such as retiree COLA's, other benefit improvements, changes in actuarial assumptions, etc.) are established as a new amortization base to be amortized over the following 30 years. Due to the recent downturn in the capital markets, there remain significant investment losses which will be recognized in accordance with the actuarial methods used to value the plan.

Overall, the total funding for the retirement fund is expected to remain stable as a percentage of payroll over future years in the absence of benefit improvements and material experience gains or losses. In particular, the current valuation funding rate does not anticipate any future cost of living increases to benefit recipients. Should these cost of living increases occur in the future, the funding rate for the retirement fund will be expected to increase as a percentage of payroll in the absence of material aggregate experience gains. In addition, rates are expected to increase as the prior mentioned investment losses are recognized.

Relative to the insurance fund, the ultimate target funding is to reach the full amount of the entry age funding level including 30-year level percent of payroll amortization of the unfunded actuarial accrued liability. However, current insurance funding levels are less than this ultimate target rate, and will be systematically increased over the 20-year period beginning with 1997 until the target funding rate is reached. As such, the insurance funding rate is expected to increase each year for the remainder of the 20-year period.

The administrative expenses are also included as part of the total funding amount. This portion of the funding is expected to remain stable as a percentage of payroll over future years.

To the extent that actual experience deviates from expected, an amortization base will be established and amortized over 30 years as a level percentage of payroll.

2. The progress towards achieving the intended funding objectives, both relative to the retirement

and insurance funds, can be measured by the relationship of valuation assets of each fund to the accrued liabilities. The funded level for the retirement fund exceeds 97% in the 2003 valuation for all three systems (KERS, CERS and SPRS). This funded level will fluctuate over time with experience deviations. Since 1992, all three systems have had a funded level relative to the retirement fund of at least 90% in all valuations.

The funded level for the insurance fund is not anywhere near 100% at this time, and the funding objective is to increase this funded level consistently over future years. Since 1990, the funded level relative to the insurance fund has improved steadily. This increasing trend in the funded level is the primary objective of the current funding policy.

3. Valuations of each system are prepared annually, with the most recent such valuation being as of June 30, 2003.
4. In completing the valuation of these systems, we have relied on employee data as provided by Kentucky Retirement Systems, as well as financial data provided by the plan's auditor. We have reviewed this data for reasonableness, and made some general edit checks to impute certain information that may not have been provided with the original employee data. However, we have not audited this data, nor has there been any reconciliation of data used in the prior year's valuation with this current valuation data.
5. We have prepared none of the supporting schedules included with this filing. However, based on a brief review of these schedules, the information included on them appears consistent with the information provided in our actuarial valuation report.
6. Any schedules of trend data over the past ten years or less have been based on valuation reports fully prepared by the plan's actuary.
7. The actuarial assumptions and methods used for the funding calculations of the valuation meet the parameters set for disclosure under GASB Statement No. 25. These assumptions have been adopted by the Board of Trustees of the Kentucky Retirement Systems in accordance with the recommendation of the actuary.
8. The information presented in items 1 through 7 of this letter describes the pertinent issues relative to the valuation. There are no other specific issues that need to be raised beyond these items in order to fairly assess the funded position of the plan as presented in the current valuation.

The three Retirement Systems are actuarially sound based on the continuation of current funding policies adopted by the Board. Adequate provision is being made for the funding of the Actuarial Accrued Liabilities of the Kentucky Employees Retirement System, the County Employees Retirement System, and the State Police Retirement System as required by the Kentucky Revised Statutes, as appropriate funding rates have been established by the Board for this purpose.

Sincerely,

THE SEGAL COMPANY

By \_\_\_\_\_  
*Leon F. (Rocky) Joyner, Jr., ASA, MAAA*  
*Vice-President and Actuary*

By \_\_\_\_\_  
*K. Eric Fredén, FSA, MAAA,*  
*Associate Actuary*

**Kentucky Retirement Systems**

**Summary of Benefit Provisions**

*(As of June 30, 2003)*

**NORMAL RETIREMENT ELIGIBILITY**

Members become eligible for an unreduced age or service annuity based upon the following requirements:

<b>Non-Hazardous Members</b>		<b>Hazardous Duty Members</b>	
<u>Age</u>	<u>Creditable Service</u>	<u>Age</u>	<u>Creditable Service</u>
65	1 Month (benefit based on account balance)	55	1 Month (benefit based on account balance)
65	4 Years (benefit based on service & salary)	55	5 Years (benefit based on service & salary)
Any	27 Years	Any	20 Years

**NORMAL RETIREMENT ANNUITY**

The annuity payable to a member under Normal Retirement provisions is based on *Final Compensation (FC)* and *Creditable Service (CS)* as follows:

<b>Non-Hazardous Members</b>	<b>Formula</b>
▪ Kentucky Employees Retirement System	1.97% x FC x CS
▪ Kentucky Employees Retirement System <i>Members who were employed January 1998 through January 1999.</i>	2.00% x FC x CS
▪ Kentucky Employees Retirement System <i>Members who were employed January 1998 through January 1999 and who retire between February 1999 and January 2009 with 20 or more years of service.</i>	2.20% x FC x CS
▪ County Employees Retirement System	2.20% x FC x CS

<b>Hazardous Duty Members</b>	<b>Formula</b>
▪ Kentucky Employees Retirement System	2.49% x FC x CS
▪ County Employees Retirement System	2.50% x FC x CS
▪ State Police Retirement System	2.50% x FC x CS

**Final Compensation (FC) for non-hazardous members** is the average of the highest five fiscal years (July to June) of earnings. The years do not have to be consecutive but must contain a minimum of 48 months.

**Exception:** For a non-hazardous member whose effective retirement date is between August 1, 2001 and January 1, 2009, and whose creditable service is at least 27 years, and whose age and years of creditable service total at least 75, final compensation is based on the average of the three highest fiscal years of earnings. The years do not have to be consecutive but must contain a minimum of 24 months.

**Final Compensation (FC) for Hazardous Duty members** is the average of the highest three fiscal years (July to June) of earnings. The years do not have to be consecutive but must contain a minimum of 24 months.

**EARLY RETIREMENT**

Members become eligible for a reduced age or service annuity based upon the requirements:

<b>Non-Hazardous Members</b>		<b>Hazardous Duty Members</b>	
<u>Age</u>	<u>Creditable Service</u>	<u>Age</u>	<u>Creditable Service</u>
55	5 Years (benefit based on service & salary)	50	15 Years (benefit based on service & salary)
Any	25 Years (benefit based on service & salary)		

Early Retirement benefits are calculated the same as Normal Retirement benefits, except that a reduction is applied depending on the member's age or years of creditable service at retirement.

**For non-hazardous members**, the amount of the reduction under early retirement provisions is based upon the lesser of the number of years required for the member to reach age 65 or 27 years of creditable service (see table below).

<b>Years to Attain Age 65 or 27 Years of Creditable Service</b>				
<div style="border: 1px solid black; padding: 5px; display: inline-block;">                     5% per year for the first five years                 </div>	1 Year:	95%	6 Years:	71%
	2 Years:	90%	7 Years:	67%
	3 Years:	85%	8 Years:	63%
	4 Years:	80%	9 Years:	59%
	5 Years:	75%	10 Years:	55%
				<div style="border: 1px solid black; padding: 5px; display: inline-block;">                     4% per year for the next five years.                 </div>

**For hazardous duty members**, the amount of the reduction under early retirement provisions is based upon the lesser of the number of years required for the member to reach age 55 or 20 years of creditable service (see table below).

<b>Years to Attain Age 55 or 20 Years of Creditable Service</b>				
<div style="border: 1px solid black; padding: 5px; display: inline-block;">                     5.5% for each year.                 </div>	1 Year:	94.5%	4 Years:	78.0%
	2 Years:	89.0%	5 Years:	72.5%
	3 Years:	83.5%		

**VOLUNTARY TERMINATION BEFORE IMMEDIATE BENEFIT ELIGIBILITY**

Upon voluntary termination a member may either (1) receive a refund of accumulated contributions and interest credited thereon, or (2) if vested, leave contributions on deposit and apply for a retirement annuity on or after the minimum retirement age based upon creditable service at the time of termination. Vesting requirements are included in each benefit described herein.

**DISABILITY BENEFITS**

**A non-hazardous member** may retire due to disability if:

- The member has at least five (5) years of creditable service, one (1) of which is credited as current service.
- The member is not eligible for an unreduced benefit from the retirement systems.
- The member applies within 24 months of the last day of paid employment in a regular full-time position.
- The medical review physicians employed by the retirement office determine the condition or disease prohibits the member from performing their job, or a job of similar duties.

**A hazardous member** may retire due to disability if:

- The member has at least five (5) years of creditable service, one (1) of which is credited as current service.
- The member is not eligible for an unreduced benefit from the retirement systems.

- The member applies within 24 months of the last day of paid employment in a regular full-time position.
- The medical review physicians employed by the retirement office determine the condition or disease is total and permanent or will render the individual totally incapable of working in a hazardous position, but may still be capable of performing other types of work.

A condition or disease which existed before a non-hazardous or hazardous member was actively contributing to the retirement system cannot be considered unless the condition was substantially aggravated by accident or injury during the course of employment or if the member has 16 years of service with a participating employer.

Disability benefits are calculated the same as for normal retirement benefits except that additional years of service may be added to the member's account, depending on the member's age and years of service.

#### Disability In the Line of Duty Benefits

A contributing **member in a non-hazardous position** who is disabled in the line of duty is entitled to a retirement benefit of not less than 25% of final monthly rate of pay. Monthly benefits shall be also be paid for each dependent child equal to 10% of the member's final monthly rate of pay, but not greater than 40% of the member's final monthly rate of pay.

A member in a **hazardous position** who is disabled in the line of duty is entitled to a retirement benefit of not less than 25% of the member's final monthly rate of pay. Monthly benefits shall be also be paid for each dependent child equal to 10% of the member's final monthly rate of pay, but not greater than 40% of the member's final monthly rate of pay.

#### **DEATH BEFORE RETIREMENT**

If a member dies before retirement, the beneficiary will be eligible for a monthly benefit based on the member's age, years of service and final compensation at the date of death if:

1. The member was eligible for normal or early retirement benefits at the date of death.
2. If the member had earned 5 years of creditable service, 1 of which is current service, and was contributing at the date of death.
3. If the member had earned 12 years of creditable service, 1 of which is current service, and was not contributing at the date of death.

If the beneficiary is a single individual, multiple individuals, an estate, or a trust the following will be offered: (1) a lump sum actuarial refund, (2) monthly benefit for five years, or (3) monthly benefit for ten years. If the named beneficiary is a single individual, the beneficiary will also have the option of a lifetime monthly benefit.

#### Death In the Line of Duty Benefits

If a **member in a non-hazardous position** dies in the line of duty and has a spouse as beneficiary, the spouse may choose: (1) a \$10,000 lump sum payment and monthly payment of 25% of the member's final monthly rate of pay or (2) benefits based upon the members age, years of service and final compensation at the date of death. Monthly benefits shall also be paid for each dependent child equal to 10% of the member's final monthly rate of pay, but not greater than 40% of the member's final monthly rate of pay.

If a **member in a hazardous position** dies in the line of duty and has a spouse as beneficiary, the spouse may choose: (1) a \$10,000 lump sum payment and a monthly payment of 25% of the member's final monthly rate of pay or (2) benefits based upon the member's age, years of service and final compensation at the date of death. If the member in a hazardous position dies in the line of duty and has a dependent as beneficiary other than his spouse, the non-spouse may choose: (1) a \$10,000 lump sum payment or (2) benefits based upon the member's age, years of service and final compensation at the date of death. Monthly benefits shall be also be paid for each dependent child equal to 10% of the member's final monthly rate of pay, but not greater than 40% of the member's final monthly rate of pay.

### **POST RETIREMENT ADJUSTMENTS**

Annuities are increased July 1 each year by the percentage increase in the annual average of the consumer price index for all urban consumers for the most recent calendar year, not to exceed five percent (5%). The Kentucky General Assembly reserves the right to suspend or reduce benefit increases if in their judgment the welfare of the State so demands.

### **DEATH AFTER RETIREMENT**

If the member is receiving a monthly benefit based on at least four (4) years of creditable service, the retirement system will pay a \$5,000 death benefit payment to the beneficiary named by the member specifically for this benefit.

### **HOSPITAL AND MEDICAL INSURANCE BENEFIT**

Kentucky Retirement Systems provides group rates on medical insurance and, where available, health maintenance organization (HMO) and other managed care coverage for retired members. Participation in the insurance/HMO program is optional and requires the completion of the proper forms at the time of retirement in order to obtain the insurance coverage.

The cost of insurance for the retired member may be partially, or fully, paid by the Systems depending upon the member's years of service, the insurance carrier selected, and the level of coverage chosen. If coverage is for the member only, the system pays the same percentage of the single monthly contribution rate for both non-hazardous and hazardous duty members. The percentage of the single monthly contribution paid by KRS based upon a member's years of creditable service is provided in the table below.

#### **Percent of the Monthly Insurance Contribution Paid Based Upon Service Credit at Retirement**

<u>Years of Creditable Service</u>	<u>% Paid</u>
At least 4 years but less than 10 years	25%
At least 10 years but less than 15 years	50%
At least 15 years but less than 20 years	75%
20 or more years	100%

If a hazardous duty member has a spouse and/or dependent children, KRS may also pay a portion of the monthly contribution towards a couple, parent plus, or family coverage plan. The portion paid toward couple, parent plus, or family coverage is based solely on the amount of creditable service the member has in an approved hazardous position (see table below).

#### **Percent of the Monthly Insurance Contribution Paid By KRS For Spouse & Dependent Coverage**

<u>Years of Creditable <b>Hazardous Duty</b> Service Credit</u>	<u>% Paid</u>
At least 4 years but less than 10 years	25%
At least 10 years but less than 15 years	50%
At least 15 years but less than 20 years	75%
20 or more years	100%

Under the provisions of House Bill 430, passed during the 2003 General Assembly, employees hired July 1, 2003 or after will be required to earn at least ten (10) years of creditable service before they will be eligible for insurance benefits at retirement. Retired members or employees who have creditable service in a KERS, CERS, or SPRS account as of July 1, 2003, will not be effected by this legislation.

If a contributing member is disabled in the line of duty, the retirement system will pay 100% of the cost for the member. If a contributing member is killed in the line of duty, the retirement system will pay 100% of the cost for the beneficiary as long as they remain eligible for a monthly benefit payment.

**INTEREST CREDITS**

Member accounts have been credited with interest on July 1 of each year at 3% compounded annually through June 30, 1980; 6% thereafter through June 30, 1986; and 4% thereafter.

**CONTRIBUTION RATES**

***Member Contributions***

State statute requires participating non-hazardous members to contribute 5% of creditable compensation. Participating hazardous duty members are required to contribute 8% of creditable compensation.

***Employer Contributions***

Employer contribution rates are determined by the entry age normal cost funding method. Actuarial gains and losses reduce or increase the unfunded liability. For years beginning with the 1990 valuation, actuarial gains and losses have been amortized over a period of thirty years using the level percent of payroll method as required by state statute.

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**NOTE: A SUMMARY PLAN DESCRIPTION WHICH GIVES A MORE DETAILED DESCRIPTION OF PLAN PROVISIONS IS AVAILABLE UPON REQUEST OR CAN BE DOWNLOADED FROM THE KENTUCKY RETIREMENT SYSTEMS' WEB PAGE AT [WWW.KYRET.COM](http://WWW.KYRET.COM).**

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**Kentucky Retirement Systems**

**Summary of Actuarial Assumptions and Methods**

**(As of June 30, 2003)**

1. The investment return rate used in making the valuations was 8.25% per year, net of investment related expenses, compounded annually. Adopted 2001.
2. The actuarial value of assets is determined in the following manner for both the Retirement Fund and Insurance Fund:
  - a. Develop expected assets by projecting valuation assets from the prior valuation using the assumed valuation interest rate from the prior valuation and actual cash flows for the 12 months ending on the current valuation date.
  - b. The current year investment gain/loss shall be determined as the difference between actual market value as of the current valuation date and expected assets as computed in (1), further adjusted for any amount of investment gain/loss from prior years not yet recognized as of the current valuation date.
  - c. The amount of investment gain/loss for the current year shall be reflected equally over the current year and the following 4 years.
  - d. Valuation assets will be equal to expected assets from (1) plus/minus the amount of investment gain/loss from the current and prior 4 years to be recognized in the current year.
  - e. The starting point for this method shall be the actuarial value of assets as computed in the 2000 valuation under the prior asset valuation method then in effect. Only investment gains/losses occurring after June 30, 2000 shall be recognized and amortized under this method.
3. The percentage of members assumed to retire at sample ages is shown in Schedule 1. Adopted 2001.
4. The mortality table used for active and retired lives was the 1983 Group Annuity Mortality Table, plus a pre-retirement duty death rate of .0005 per year for hazardous duty employees. Mortality assumptions for disabled lives are based on Social Security Administration Disability Mortality Rates – Actuarial Study No. 75 (current rates used by PBGC for disabled lives receiving Social Security). Sample annual rates of mortality are shown in Schedule 2. Adopted 2001.
5. Select rates of termination before retirement are shown in Schedule 3. Adopted 2001.
6. Annual pay per member is assumed to increase 12% in the first year, 10% in the second year, 8% in the third year and 6.50% per year thereafter, compounded annually, which is based on experience rather than the effects of inflation. Adopted 2001.
7. Kentucky Revised Statutes require use of the entry age normal cost funding method to determine the actuarial accrued liability. Actuarial gains and losses reduce or increase the unfunded liability. For years beginning with the 1990 valuation, actuarial gains and losses have been amortized over a period of thirty years using the level percent of payroll method as required by state statute.
8. With respect to cost-of-living adjustments, effective August 1, 1996, and on July 1 of each year thereafter, state statutes require retirement benefits to be increased by the percentage increase in the annual average of the consumer price index for all urban consumers for the most recent calendar year, not to exceed five percent. The State Legislature reserved the right to suspend or reduce cost-of-living adjustments if in their judgment the welfare of the Commonwealth so demands.
9. The most recent actuarial experience analysis was performed for the period from July 1, 1995 through June 30, 2000. All assumptions used in the most recent actuarial valuation were based on the study performed in 2001.

Assumptions used in determining the actuarial accrued liability for postemployment healthcare benefits are shown in Schedule 4. Adopted 2001.

**SCHEDULE 1: PERCENTAGE OF PARTICIPANTS ASSUMED TO RETIRE AT SAMPLE AGES**

Age	<u>55-57</u>	<u>58-59</u>	<u>60-61</u>	<u>62</u>	<u>63-64</u>	<u>65</u>	<u>66-67</u>	<u>68</u>	<u>69</u>	<u>70 &amp; Over</u>
Percent Retiring	4%	5%	6%	25%	10%	50%	20%	25%	40%	100%

At age 55-64 in lieu of age related rate, 25% are assumed to retire as soon as eligible for unreduced benefits with 27 years of creditable service.

For hazardous duty participants of the Kentucky Employees Retirement System it is assumed that 50% will retire as soon as eligible for unreduced benefits with 20 years of creditable service and the balance will continue to age 60.

For hazardous duty participants of the County Employees Retirement System it is assumed that 60% will retire as soon as eligible for unreduced benefits with 20 years of creditable service and the balance will continue to age 55.

For participants of the State Police Retirement System it is assumed that 60% will retire as soon as eligible for unreduced benefits with 20 years of creditable service and the balance will continue to age 55.

**SCHEDULE 2: SAMPLE ANNUAL RATES OF MORTALITY**

Age	<i>Active Mortality*</i>		<i>Disabled Mortality</i>	
	<u>Males</u>	<u>Females</u>	<u>Males</u>	<u>Females</u>
25	0.05%	0.03%	4.83%	2.63%
30	0.06%	0.03%	3.62%	2.37%
40	0.12%	0.07%	2.82%	2.09%
50	0.40%	0.16%	3.83%	2.57%
55	0.61%	0.25%	4.82%	2.95%
60	0.92%	0.42%	6.03%	3.31%

\*Plus 0.05% duty death rate prior to retirement for hazardous duty participants.

**SCHEDULE 3: SELECT OF TERMINATION PRIOR TO RETIREMENT**

<i>Kentucky Employees Retirement System</i>					
Sample Ages	Years of Service	<i>Termination</i>		<i>Disablement</i>	
		<u>Non-Hazardous Employees</u>	<u>Hazardous Employees</u>	<u>Non-Hazardous Employees</u>	<u>Hazardous Employees</u>
	1	35.00%	30.00%	**	**
	2	10.00%	8.00%	**	**
	3	7.00%	4.00%	**	**
	4	5.00%	4.00%	**	**
	5	4.00%	4.00%	**	**
25	Over 5	2.40%	3.04%	0.033%	0.042%
30		2.40%	3.38%	0.039%	0.050%
40		2.00%	1.50%	0.105%	0.132%
50		1.60%	0.00%	0.423%	0.530%
55		1.20%	0.00%	0.794%	0.992%
60		0.20%	0.00%	1.395%	1.743%

\*\*Same as age-based rates for over five years of service.

**County Employees Retirement System**

Sample Ages	Years of Service	Termination		Disablement	
		Non-Hazardous Employees	Hazardous Employees	Non-Hazardous Employees	Hazardous Employees
	1	35.00%	30.00%	**	**
	2	10.00%	8.00%	**	**
	3	7.00%	4.00%	**	**
	4	5.00%	4.00%	**	**
	5	4.00%	4.00%	**	**
25	Over 5	2.40%	3.04%	0.033%	0.042%
30		2.40%	3.38%	0.039%	0.050%
40		2.00%	1.50%	0.105%	0.132%
50		1.60%	0.00%	0.423%	0.530%
55		1.20%	0.00%	0.794%	0.992%
60		0.20%	0.00%	1.395%	1.743%

\*\*Same as age-based rates for over five years of service.

**State Police Retirement System**

Sample Ages	Years of Service	Termination	Disablement
		Hazardous Employees	Hazardous Employees
	1	**	**
	2	**	**
	3	**	**
	4	**	**
	5	**	**
25	Over 5	1.82%	0.042%
30		2.03%	0.050%
40		0.90%	0.132%
50		0.00%	0.530%
55		0.00%	0.992%
60		0.00%	1.743%

\*\*Same as age-based rates for over five years of service.

**SCHEDULE 4: ASSUMED MEDICAL PREMIUM GROWTH**

Years	2003 – 2005	2006 – 2010	2011 -- 2015	2016 -- 2020	Thereafter
Increase Per Year	10%	9%	8%	7.5%	7%

**Kentucky Retirement Systems****Summary of Member Valuation Data***(As of June 30, 2003)***KENTUCKY EMPLOYEES RETIREMENT SYSTEM (NON-HAZARDOUS)****Schedule of Active Member Valuation Data**

Valuation Date	Active Participants	Annual Payroll	Annual Average Pay	% Increase In Average Pay
6/30/1998	46,342	\$1,272,316,548	\$27,455	4.7%
6/30/1999	45,824	\$1,330,937,460	\$29,046	5.8%
6/30/2000	46,897	\$1,432,316,220	\$30,542	5.2%
6/30/2001	47,780	\$1,525,188,532	\$31,921	4.5%
6/30/2002	48,555	\$1,597,447,963	\$32,900	3.1%
6/30/2003	49,158	\$1,658,604,696	\$33,740	2.6%

**KENTUCKY EMPLOYEES RETIREMENT SYSTEM (HAZARDOUS)****Schedule of Active Member Valuation Data**

Valuation Date	Active Participants	Annual Payroll	Annual Average Pay	% Increase In Average Pay
6/30/1998	3,582	\$ 88,891,680	\$24,816	4.1%
6/30/1999	3,889	\$103,970,148	\$26,734	7.7%
6/30/2000	4,007	\$115,135,008	\$28,733	7.5%
6/30/2001	4,228	\$123,647,407	\$29,245	1.8%
6/30/2002	4,211	\$125,371,604	\$29,772	1.8%
6/30/2003	4,189	\$129,088,956	\$30,816	3.5%

**COUNTY EMPLOYEES RETIREMENT SYSTEM (NON-HAZARDOUS)****Schedule of Active Member Valuation Data**

Valuation Date	Active Participants	Annual Payroll	Annual Average Pay	% Increase In Average Pay
6/30/1998	71,426	\$1,341,570,672	\$18,783	1.4%
6/30/1999	74,151	\$1,449,817,548	\$19,552	4.1%
6/30/2000	77,419	\$1,575,632,580	\$20,352	4.1%
6/30/2001	78,773	\$1,597,653,320	\$20,282	(0.3%)
6/30/2002	79,850	\$1,688,460,789	\$21,145	4.3%
6/30/2003	82,288	\$1,796,451,180	\$21,831	3.2%

**COUNTY EMPLOYEES RETIREMENT SYSTEM (HAZARDOUS)****Schedule of Active Member Valuation Data**

Valuation Date	Active Participants	Annual Payroll	Annual Average Pay	% Increase In Average Pay
6/30/1998	6,800	\$227,851,248	\$33,508	3.8%
6/30/1999	7,488	\$260,279,940	\$34,760	3.7%
6/30/2000	7,951	\$291,062,928	\$36,607	5.3%
6/30/2001	8,586	\$322,819,064	\$37,598	2.7%
6/30/2002	8,949	\$346,319,146	\$38,699	2.9%
6/30/2003	9,286	\$374,700,732	\$40,351	4.3%

**STATE POLICE RETIREMENT SYSTEM****Schedule of Active Member Valuation Data**

Valuation Date	Active Participants	Annual Payroll	Annual Average Pay	% Increase In Average Pay
6/30/1998	954	\$35,865,072	\$37,594	1.4%
6/30/1999	985	\$40,548,636	\$41,166	9.5%
6/30/2000	1,023	\$43,596,396	\$42,616	3.5%
6/30/2001	1,016	\$44,209,944	\$43,514	2.1%
6/30/2002	1,002	\$43,961,844	\$43,874	0.8%
6/30/2003	1,019	\$43,760,832	\$42,945	(2.1%)

**ALL SYSTEMS****Schedule of Active Member Valuation Data**

Valuation Date	Participating Employers	Active Participants	Annual Payroll	Annual Average Pay	% Increase In Average Pay
6/30/1998	1,841	129,104	\$2,966,495,220	\$22,978	2.9%
6/30/1999	1,531	132,337	\$3,185,553,732	\$24,072	4.8%
6/30/2000	1,610	137,297	\$3,457,743,132	\$25,184	4.6%
6/30/2001	1,706	140,383	\$3,613,518,267	\$25,740	2.2%
6/30/2002	1,727	142,567	\$3,801,561,346	\$26,665	3.6%
6/30/2003	1,778	145,940	\$4,002,606,396	\$27,426	2.9%

**Kentucky Retirement Systems****Summary of Accrued & Unfunded Liabilities***(As of June 30, 2003)***KENTUCKY EMPLOYEES RETIREMENT SYSTEM : PENSION FUND***(Expressed in Thousands)*

Valuation Date	Actuarial Liability	Unfunded Liability	Percent Unfunded	Actuarial Value of Assets	Increase In Assets
6/30/1998	\$3,971,749	(\$ 596,537)	(15.00%)	\$4,568,287	\$717,575
6/30/1999	\$4,531,905	(\$ 992,274)	(21.90%)	\$5,524,179	\$955,892
6/30/2000	\$5,120,191	(\$2,022,698)	(39.50%)	\$7,142,889	\$1,618,710
6/30/2001*	\$5,729,229	(\$1,477,191)	(25.80%)	\$7,206,420	\$63,531
6/30/2002	\$6,348,164	(\$ 682,305)	(10.70%)	\$7,030,468	(\$175,952)
6/30/2003	\$6,877,342	\$ 140,098	2.04%	\$6,737,245	(\$293,223)

*\*Change in asset valuation method effective in this valuation to 5-year smoothing of investment gains/(losses).***KENTUCKY EMPLOYEES RETIREMENT SYSTEM : INSURANCE FUND***(Expressed in Thousands)*

Valuation Date	Actuarial Liability	Unfunded Liability	Percent Unfunded	Actuarial Value of Assets	Increase In Assets
6/30/1998	\$1,379,578	\$1,114,866	80.80%	\$264,711	\$53,547
6/30/1999	\$1,422,523	\$1,064,238	74.80%	\$358,284	\$93,572
6/30/2000	\$1,632,643	\$1,130,871	69.30%	\$501,772	\$143,488
6/30/2001*	\$1,984,034	\$1,415,031	71.30%	\$569,003	\$67,231
6/30/2002	\$2,144,503	\$1,487,378	69.40%	\$657,125	\$88,122
6/30/2003	\$2,376,389	\$1,671,044	70.32%	\$705,345	\$48,220

*\*Change in asset valuation method effective in this valuation to 5-year smoothing of investment gains/(losses).***COUNTY EMPLOYEES RETIREMENT SYSTEM : PENSION FUND***(Expressed in Thousands)*

Valuation Date	Actuarial Liability	Unfunded Liability	Percent Unfunded	Actuarial Value of Assets	Increase In Assets
6/30/1998	\$3,529,912	(\$743,349)	(21.10%)	\$4,273,262	\$759,236
6/30/1999	\$3,955,132	(\$1,241,746)	(31.40%)	\$5,196,878	\$923,616
6/30/2000	\$4,453,155	(\$2,276,421)	(51.10%)	\$6,729,576	\$1,532,698
6/30/2001*	\$4,900,143	(\$2,010,358)	(41.00%)	\$6,910,500	\$180,924
6/30/2002	\$5,492,646	(\$1,390,653)	(25.30%)	\$6,883,299	(\$27,202)
6/30/2003	\$5,917,227	(\$836,358)	(14.13%)	\$6,753,585	(\$129,714)

*\*Change in asset valuation method effective in this valuation to 5-year smoothing of investment gains/(losses).*

**COUNTY EMPLOYEES RETIREMENT SYSTEM : INSURANCE FUND***(Expressed in Thousands)*

Valuation Date	Actuarial Liability	Unfunded Liability	Percent Unfunded	Actuarial Value of Assets	Increase In Assets
6/30/1998	\$1,706,626	\$1,451,039	85.00%	\$255,586	\$51,065
6/30/1999	\$1,801,154	\$1,454,627	80.80%	\$346,527	\$90,941
6/30/2000	\$2,066,653	\$1,578,352	76.40%	\$488,301	\$141,774
6/30/2001*	\$2,515,316	\$1,954,682	77.40%	\$569,634	\$81,333
6/30/2002	\$2,758,762	\$2,073,581	75.20%	\$685,181	\$115,547
6/30/2003	\$3,112,614	\$2,323,364	74.64%	\$789,250	\$104,069

\*Change in asset valuation method effective in this valuation to 5-year smoothing of investment gains/(losses).

**STATE POLICE RETIREMENT SYSTEM : PENSION FUND***(Expressed in Thousands)*

Valuation Date	Actuarial Liability	Unfunded Liability	Percent Unfunded	Actuarial Value of Assets	Increase In Assets
6/30/1998	\$294,427	(\$11,891)	(4.00%)	\$306,318	\$26,675
6/30/1999	\$314,021	(\$43,601)	(13.90%)	\$357,623	\$51,304
6/30/2000	\$336,580	(\$122,589)	(36.40%)	\$459,169	\$101,546
6/30/2001*	\$356,212	(\$99,949)	(28.10%)	\$456,161	(\$3,008)
6/30/2002	\$380,790	(\$58,165)	(15.30%)	\$438,955	(\$17,205)
6/30/2003	\$414,881	\$1,818	0.44%	\$413,064	(\$25,891)

\*Change in asset valuation method effective in this valuation to 5-year smoothing of investment gains/(losses).

**STATE POLICE RETIREMENT SYSTEM : INSURANCE FUND***(Expressed in Thousands)*

Valuation Date	Actuarial Liability	Unfunded Liability	Percent Unfunded	Actuarial Value of Assets	Increase In Assets
6/30/1998	\$124,501	\$83,090	66.70%	\$41,410	\$7,534
6/30/1999	\$125,797	\$71,867	57.10%	\$53,929	\$12,519
6/30/2000	\$138,867	\$67,155	48.40%	\$71,712	\$17,783
6/30/2001*	\$158,261	\$78,398	49.50%	\$79,864	\$8,152
6/30/2002	\$165,445	\$78,578	47.50%	\$86,867	\$7,004
6/30/2003	\$184,501	\$93,753	50.81%	\$90,748	\$3,881

\*Change in asset valuation method effective in this valuation to 5-year smoothing of investment gains/(losses).

**Kentucky Retirement Systems****Solvency Test**  
*(As of June 30, 2003)***KENTUCKY EMPLOYEES RETIREMENT SYSTEM***(Expressed in Thousands)*

Valuation Date	Aggregate Accrued Liabilities For			Reported Assets	Portion of Accrued Liabilities Covered by Reported Assets		
	(1) Active Member Contributions	(2) Retirants And Beneficiaries	(3) Active Members (Employer Financed Portion)		(1)	(2)	(3)
6/30/1998	\$752,816	\$1,711,602	\$1,507,332	\$4,568,287	100%	100%	139.6%
6/30/1999	\$862,558	\$1,935,471	\$1,733,877	\$5,524,180	100%	100%	157.2%
6/30/2000	\$900,839	\$2,378,236	\$1,841,116	\$7,142,889	100%	100%	209.9%
6/30/2001	\$895,839	\$2,756,127	\$2,077,262	\$7,206,420	100%	100%	171.1%
6/30/2002	\$988,657	\$3,352,392	\$2,007,115	\$7,030,468	100%	100%	134.0%
6/30/2003	\$931,310	\$3,980,318	\$1,965,714	\$6,737,248	100%	100%	92.9%

**COUNTY EMPLOYEES RETIREMENT SYSTEM***(Expressed in Thousands)*

Valuation Date	Aggregate Accrued Liabilities For			Reported Assets	Portion of Accrued Liabilities Covered by Reported Assets		
	(1) Active Member Contributions	(2) Retirants And Beneficiaries	(3) Active Members (Employer Financed Portion)		(1)	(2)	(3)
6/30/1998	\$685,806	\$1,355,013	\$1,489,094	\$4,273,262	100%	100%	150.00%
6/30/1999	\$759,922	\$1,600,392	\$1,594,819	\$5,196,879	100%	100%	177.90%
6/30/2000	\$821,630	\$1,904,182	\$1,727,343	\$6,729,576	100%	100%	231.80%
6/30/2001	\$855,815	\$2,185,378	\$1,858,950	\$6,910,501	100%	100%	208.10%
6/30/2002	\$1,007,019	\$2,525,608	\$1,960,019	\$6,883,299	100%	100%	171.00%
6/30/2003	\$987,568	\$2,838,286	\$2,091,373	\$6,753,585	100%	100%	140.0%

**STATE POLICE RETIREMENT SYSTEM***(Expressed in Thousands)*

Valuation Date	Aggregate Accrued Liabilities For			Reported Assets	Portion of Accrued Liabilities Covered by Reported Assets		
	(1) Active Member Contributions	(2) Retirants And Beneficiaries	(3) Active Members (Employer Financed Portion)		(1)	(2)	(3)
6/30/1998	\$30,546	\$183,652	\$80,229	\$306,319	100%	100%	114.80%
6/30/1999	\$33,633	\$187,163	\$93,226	\$357,623	100%	100%	146.80%
6/30/2000	\$36,111	\$199,749	\$100,720	\$459,169	100%	100%	221.70%
6/30/2001	\$34,338	\$224,433	\$97,441	\$456,161	100%	100%	202.60%
6/30/2002	\$36,886	\$252,499	\$91,405	\$438,955	100%	100%	163.60%
6/30/2003	\$35,832	\$290,013	\$89,037	\$413,064	100%	100%	98.0%

**Kentucky Retirement Systems**

**KERS Retired Lives Summary**

*(As of June 30, 2003)*

**KENTUCKY EMPLOYEES RETIREMENT SYSTEM (KERS)**

	<u>Non-Hazardous Retirees</u>		<u>Hazardous Retirees</u>		<u>Total</u>	
	Number	Monthly Benefits	Number	Monthly Benefits	Number	Monthly Benefits
Basic Form	9,074	\$9,750,567	320	\$210,316	9,394	\$9,960,883
Joint & Survivor						
100% to Beneficiary	2,239	\$2,437,608	127	\$106,698	2,366	\$2,544,306
66 2/3% to Beneficiary	917	\$1,676,661	48	\$41,813	965	\$1,718,474
50% to Beneficiary	1,582	\$2,628,738	72	\$77,358	1,654	\$2,706,096
Pop-Up Option	3,102	\$5,211,263	261	\$246,994	3,363	\$5,458,257
10 Years Certain	---	---	22	\$25,597	22	\$25,597
10 Years Certain & Life	2,583	\$2,570,364	102	\$69,168	2,685	\$2,639,532
15 Years Certain & Life	711	\$857,896	38	\$30,352	749	\$888,248
20 Years Certain & Life	581	\$850,021	35	\$32,124	616	\$882,145
Social Security Option						
Basic Form	1,286	\$2,014,703	53	\$43,350	1,339	\$2,058,053
Survivorship Option	1,269	\$2,053,795	89	\$88,107	1,358	\$2,141,902
Partial Lump Sum Option						
PLSO 12 Month Basic	39	\$44,633	4	\$4,072	43	\$48,704
PLSO 24 Month Basic	19	\$13,291	3	\$3,027	22	\$16,319
PLSO 36 Month Basic	50	\$31,760	6	\$3,611	56	\$35,371
PLSO 12 Month Survivor	18	\$22,562	2	\$1,921	20	\$24,483
PLSO 24 Month Survivor	22	\$20,482	3	\$3,448	25	\$23,929
PLSO 36 Month Survivor	34	\$19,319	5	\$2,819	39	\$22,138
5 Years Only	1	\$1,590	0	\$0	1	\$1,590
Dependent Child	3	\$1,194	15	\$3,614	18	\$4,808
<b>TOTAL</b>	<b>23,530</b>	<b>\$30,206,449</b>	<b>1,205</b>	<b>\$994,388</b>	<b>24,735</b>	<b>\$31,200,838</b>

**Kentucky Retirement Systems**

**CERS Retired Lives Summary**  
(As of June 30, 2003)

**COUNTY EMPLOYEES RETIREMENT SYSTEM (CERS)**

	<u>Non-Hazardous Retirees</u>		<u>Hazardous Retirees</u>		<u>Total</u>	
	Number	Monthly Benefits	Number	Monthly Benefits	Number	Monthly Benefits
Basic Form	10,887	\$6,090,988	531	\$844,042	11,418	\$6,935,030
Joint & Survivor						
100% to Beneficiary	2,341	\$1,579,166	404	\$621,465	2,745	\$2,200,631
66 2/3% to Beneficiary	686	\$823,343	184	\$385,563	870	\$1,208,906
50% to Beneficiary	1,238	\$1,231,648	276	\$515,434	1,514	\$1,747,082
Pop-Up Option	2,751	\$2,753,783	1,120	\$2,133,051	3,871	\$4,886,835
10 Years Certain	0	\$0	38	\$68,699	38	\$68,699
10 Years Certain & Life	3,368	\$1,844,814	159	\$248,774	3,527	\$2,093,588
15 Years Certain & Life	847	\$558,431	48	\$69,574	895	\$628,005
20 Years Certain & Life	571	\$469,418	105	\$157,819	676	\$627,236
Social Security Option						
Basic Form	557	\$614,956	98	\$144,454	655	\$759,409
Survivorship Option	640	\$859,392	301	\$425,591	941	\$1,284,984
Partial Lump Sum Option	47	\$27,245	8	\$10,304	55	\$37,549
PLSO 12 Month Basic	23	\$10,213	6	\$8,830	29	\$19,043
PLSO 24 Month Basic	97	\$38,820	4	\$2,621	101	\$41,441
PLSO 36 Month Basic	29	\$33,012	5	\$10,156	34	\$43,167
PLSO 12 Month Survivor	19	\$12,372	5	\$5,068	24	\$17,440
PLSO 24 Month Survivor	66	\$25,659	14	\$16,092	80	\$41,751
PLSO 36 Month Survivor						
5 Years Only	0	\$0	0	\$0	0	\$0
Dependent Child	4	\$905	163	\$49,886	167	\$50,791
<b>TOTAL</b>	<b>24,167</b>	<b>\$16,974,165</b>	<b>3,469</b>	<b>\$5,717,422</b>	<b>27,473</b>	<b>\$22,640,796</b>

**SPRS Retired Lives Summary**

*(As of June 30, 2003)*

<b>STATE POLICE RETIREMENT SYSTEM (SPRS)</b>		
	Number	Monthly Benefits
Basic Form	83	\$208,174
Joint & Survivor		
100% to Beneficiary	115	\$274,322
66 2/3% to Beneficiary	66	\$197,441
50% to Beneficiary	66	\$181,888
Pop-Up Option	243	\$697,252
10 Years Certain	6	\$21,599
10 Years Certain & Life	23	\$61,226
15 Years Certain & Life	9	\$20,995
20 Years Certain & Life	31	\$69,259
Social Security Option		
Basic Form	36	\$79,284
Survivorship Option	167	\$352,114
Partial Lump Sum Option		
PLSO 12 Month Basic	---	---
PLSO 24 Month Basic	---	---
PLSO 36 Month Basic	---	---
PLSO 12 Month Survivor	---	---
PLSO 24 Month Survivor	---	---
PLSO 36 Month Survivor	---	---
5 Years Only	1	\$2,659
Dependent Child	11	\$3,336
<b>TOTAL</b>	<b>857</b>	<b>\$2,169,550</b>

**KERS Beneficiary Summary***(As of June 30, 2003)***KENTUCKY EMPLOYEES RETIREMENT SYSTEM (KERS)**

	<u>Non-Hazardous Retirees</u>		<u>Hazardous Retirees</u>		<u>Total</u>	
	Number	Monthly Benefits	Number	Monthly Benefits	Number	Monthly Benefits
Joint & Survivor						
100% to Beneficiary	1,879	\$1,192,277	71	\$41,736	1,950	\$1,234,013
66 2/3% to Beneficiary	287	\$168,212	4	\$2,179	291	\$170,390
50% to Beneficiary	538	\$214,076	13	\$4,170	551	\$218,246
Pop-Up Option	243	\$214,057	15	\$7,481	258	\$221,538
5 Years Certain						
10 Years Certain	95	\$105,471	7	\$7,313	102	\$112,783
10 Years Certain & Life	132	\$114,381	14	\$7,624	146	\$122,005
15 Years Certain & Life	116	\$108,371	2	\$689	118	\$109,061
20 Years Certain & Life	92	\$89,987	4	\$966	96	\$90,954
Social Security Option						
Survivorship Option	177	\$216,959	9	\$8,442	186	\$225,401
Beneficiary Under 60	15	\$5,654	0	\$0	15	\$5,654
Dependent Child						
	0	\$0	1	\$299	1	\$299
Partial Lump Sum Option						
PLSO 12 Month Basic	---	---	---	---	---	---
PLSO 24 Month Basic	---	---	---	---	---	---
PLSO 36 Month Basic	---	---	---	---	---	---
PLSO 12 Month Survivor	---	---	---	---	---	---
PLSO 24 Month Survivor	---	---	---	---	---	---
PLSO 36 Month Survivor	---	---	---	---	---	---
<b>TOTAL</b>	<b>3,704</b>	<b>\$2,547,615</b>	<b>152</b>	<b>\$86,839</b>	<b>3,856</b>	<b>\$2,634,454</b>

**Kentucky Retirement Systems**

**CERS Beneficiary Summary**

*(As of June 30, 2003)*

**COUNTY EMPLOYEES RETIREMENT SYSTEM (CERS)**

	<u>Non-Hazardous Retirees</u>		<u>Hazardous Retirees</u>		<u>Total</u>	
	Number	Monthly Benefits	Number	Monthly Benefits	Number	Monthly Benefits
<b>Joint &amp; Survivor</b>						
100% to Beneficiary	1,391	\$542,614	92	\$93,479	1,483	\$636,093
66 2/3% to Beneficiary	154	\$64,198	19	\$22,420	173	\$86,617
50% to Beneficiary	290	\$90,287	21	\$12,080	311	\$102,367
Pop-Up Option	238	\$138,676	49	\$69,131	287	\$207,807
<b>5 Years Certain</b>						
10 Years Certain	161	\$94,978	21	\$29,775	182	\$124,753
<b>10 Years Certain &amp; Life</b>						
15 Years Certain & Life	125	\$74,966	1	\$605	126	\$75,571
20 Years Certain & Life	89	\$61,324	9	\$14,058	98	\$75,382
<b>Social Security Option</b>						
Survivorship Option	59	\$56,803	37	\$54,779	96	\$111,582
Beneficiary Under 60	4	\$655	3	\$2,266	7	\$2,921
<b>Dependent Child</b>						
	2	\$316	1	\$309	3	\$625
<b>Partial Lump Sum Option</b>						
PLSO 12 Month Basic	---	---	---	---	---	---
PLSO 24 Month Basic	---	---	---	---	---	---
PLSO 36 Month Basic	---	---	---	---	---	---
PLSO 12 Month Survivor	1	\$535	---	---	1	\$535
PLSO 24 Month Survivor	---	---	---	---	---	---
PLSO 36 Month Survivor	---	---	---	---	---	---
<b>TOTAL</b>	<b>2,921</b>	<b>\$1,346,521</b>	<b>268</b>	<b>\$309,425</b>	<b>3,189</b>	<b>\$1,655,946</b>

**SPRS Beneficiary Summary**  
*(As of June 30, 2003)*

**STATE POLICE RETIREMENT SYSTEM (SPRS)**

	Number	Monthly Benefits
Basic Form		
Joint & Survivor		
100% to Beneficiary	52	\$109,453
66 2/3% to Beneficiary	1	\$1,242
50% to Beneficiary	10	\$13,629
Pop-Up Option	6	\$16,054
10 Years Certain	0	\$0
10 Years Certain & Life	0	\$0
15 Years Certain & Life	0	\$0
20 Years Certain & Life	2	\$7,732
Social Security Option		
Basic Form		
Survivorship Option	12	\$25,037
Partial Lump Sum Option		
PLSO 12 Month Basic	---	---
PLSO 24 Month Basic	---	---
PLSO 36 Month Basic	---	---
PLSO 12 Month Survivor	---	---
PLSO 24 Month Survivor	---	---
PLSO 36 Month Survivor	---	---
Dependent Child	1	\$265
<b>TOTAL</b>	<b>84</b>	<b>\$173,412</b>

# KENTUCKY RETIREMENT SYSTEMS

## **Statistical Section**

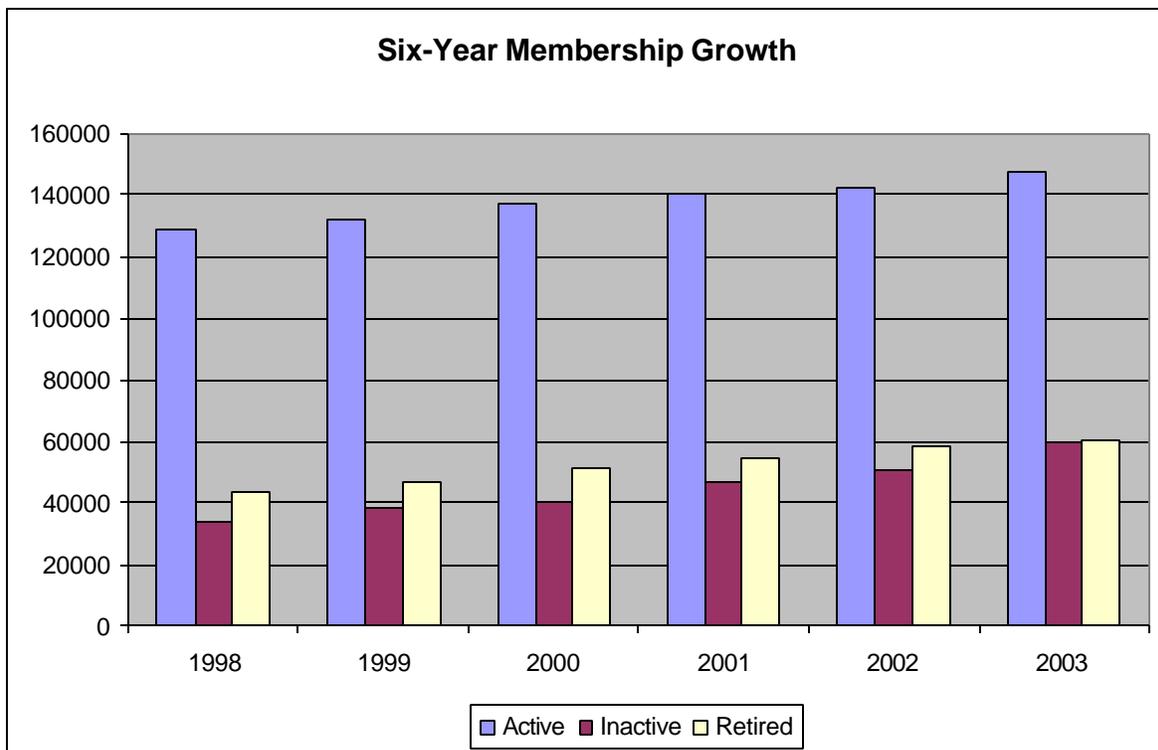
*Comprehensive Annual Financial Report*  
June 30, 2003

**Kentucky Retirement Systems**

# Membership by System

(As of June 30, 2003)

SYSTEM	ACTIVE	INACTIVE	RETIRED & BENEFICIARIES RECEIVING BENEFITS	TOTAL
<b>KERS</b>	49,586	21,212	27,182	97,980
<b>KERS Hazardous</b>	4,203	1,402	1,365	6,970
<b>TOTAL KERS</b>	<b>53,789</b>	<b>22,614</b>	<b>28,547</b>	<b>104,950</b>
<b>CERS</b>	83,142	35,720	27,057	145,919
<b>CERS Hazardous</b>	9,587	1,066	3,787	14,440
<b>TOTAL CERS</b>	<b>92,729</b>	<b>36,786</b>	<b>30,844</b>	<b>160,359</b>
<b>SPRS</b>	1,022	229	966	2,217
<b>GRAND TOTAL</b>	<b>147,540</b>	<b>59,629</b>	<b>60,357</b>	<b>267,526</b>



**Kentucky Retirement Systems****Schedule of Participating Employers**

<b>KENTUCKY EMPLOYEES RETIREMENT SYSTEM</b>	
<b>Agency Classification</b>	<b>Number of Agencies</b>
Agencies Reporting Through State Payroll	214
Other Agencies (universities, mental health boards, health departments)	123
Special Districts and Boards	4
Child Support Offices (county attorneys)	66
Other State-Administered Retirement Systems	3
<b>TOTAL</b>	<b>410</b>

<b>COUNTY EMPLOYEES RETIREMENT SYSTEM</b>	
<b>Agency Classification</b>	<b>Number of Agencies</b>
Area Development Districts	14
Boards of Education	176
Cities	255
County Attorneys	59
County Clerks	13
County Government Agencies	254
Fire Departments	63
Hospitals	3
Jailers	8
Libraries	83
Planning Commissions	9
Police Departments	63
Police & Fire Departments (combined)	41
Sanitation Districts	4
Sheriff Departments	43
Special Districts and Boards	173
Utility Boards	102
Urban County Government Agencies	4
<b>TOTAL</b>	<b>1,367</b>

<b>STATE POLICE RETIREMENT SYSTEM</b>	
<b>Agency Classification</b>	<b>Number of Agencies</b>
Kentucky State Police-Uniformed Officers	1

**Kentucky Retirement Systems**

**SCHEDULE OF REVENUE BY SOURCE**

*(Expressed in thousands)*

<b>KENTUCKY EMPLOYEES RETIREMENT SYSTEM</b>				
<b>Year Ending</b>	<b>Member Contributions</b>	<b>Employer Contributions</b>	<b>Investment Income</b>	<b>Total</b>
June 30, 1998	\$ 74,115	\$128,221	\$ 997,451	\$1,199,787
June 30, 1999	\$149,722	\$126,959	\$ 889,768	\$1,166,449
June 30, 2000	\$117,209	\$136,688	\$ 333,006	\$ 586,903
June 30, 2001	\$117,225	\$114,210	(\$ 387,886)	(\$ 156,451)
June 30, 2002	\$122,799	\$119,494	(\$ 238,838)	\$3,455
June 30, 2003	\$148,677	\$96,137	\$219,325	\$464,139

<b>COUNTY EMPLOYEES RETIREMENT SYSTEM</b>				
<b>Year Ending</b>	<b>Member Contributions</b>	<b>Employer Contributions</b>	<b>Investment Income</b>	<b>Total</b>
June 30, 1998	\$ 90,963	\$149,824	\$ 903,101	\$1,143,888
June 30, 1999	\$121,484	\$158,882	\$ 818,969	\$1,099,335
June 30, 2000	\$125,152	\$158,326	\$ 295,579	\$ 579,057
June 30, 2001	\$128,876	\$164,338	(\$ 317,544)	(\$ 24,330)
June 30, 2002	\$159,524	\$164,464	(\$ 288,882)	\$ 35,106
June 30, 2003	\$161,504	\$173,241	\$219,150	\$553,895

<b>STATE POLICE RETIREMENT SYSTEM</b>				
<b>Year Ending</b>	<b>Member Contributions</b>	<b>Employer Contributions</b>	<b>Investment Income</b>	<b>Total</b>
June 30, 1998	\$2,711	\$ 9,574	\$75,292	\$ 87,577
June 30, 1999	\$3,658	\$ 9,463	\$76,389	\$ 89,510
June 30, 2000	\$4,202	\$10,216	\$22,601	\$ 37,019
June 30, 2001	\$4,138	\$ 9,629	(\$33,885)	(\$ 20,118)
June 30, 2002	\$4,499	\$ 9,562	(\$22,770)	(\$ 8,709)
June 30, 2003	\$4,674	\$7,634	\$14,947	\$27,255

**Kentucky Retirement Systems****SCHEDULE OF EXPENSES BY TYPE***(Expressed in thousands)*

<b>KENTUCKY EMPLOYEES RETIREMENT SYSTEM</b>					
<b>Year Ending</b>	<b>Benefit Payments</b>	<b>Administrative Expenses</b>	<b>Refunds</b>	<b>Medical Insurance Expenses</b>	<b>Total</b>
<b>June 30, 1998</b>	\$193,569	\$2,628	\$9,196	\$24,521	\$229,914
<b>June 30, 1999</b>	\$209,339	\$3,448	\$9,168	\$25,829	\$247,784
<b>June 30, 2000</b>	\$258,999	\$3,792	\$9,041	\$32,085	\$303,917
<b>June 30, 2001</b>	\$299,700	\$4,461	\$8,221	\$39,618	\$352,000
<b>June 30, 2002</b>	\$355,869	\$5,127	\$7,798	\$46,565	\$415,359
<b>June 30, 2003</b>	\$418,269	\$5,363	\$8,418	\$54,944	\$486,994

<b>COUNTY EMPLOYEES RETIREMENT SYSTEM</b>					
<b>Year Ending</b>	<b>Benefit Payments</b>	<b>Administrative Expenses</b>	<b>Refunds</b>	<b>Medical Insurance Expenses</b>	<b>Total</b>
<b>June 30, 1998</b>	\$142,405	\$4,030	\$10,173	\$23,138	\$179,746
<b>June 30, 1999</b>	\$165,107	\$5,385	\$10,924	\$25,841	\$207,257
<b>June 30, 2000</b>	\$197,637	\$6,228	\$12,248	\$31,705	\$247,818
<b>June 30, 2001</b>	\$226,776	\$7,039	\$10,313	\$39,423	\$283,551
<b>June 30, 2002</b>	\$260,153	\$8,197	\$10,095	\$46,267	\$324,712
<b>June 30, 2003</b>	\$302,849	\$8,981	\$12,007	\$54,664	\$378,501

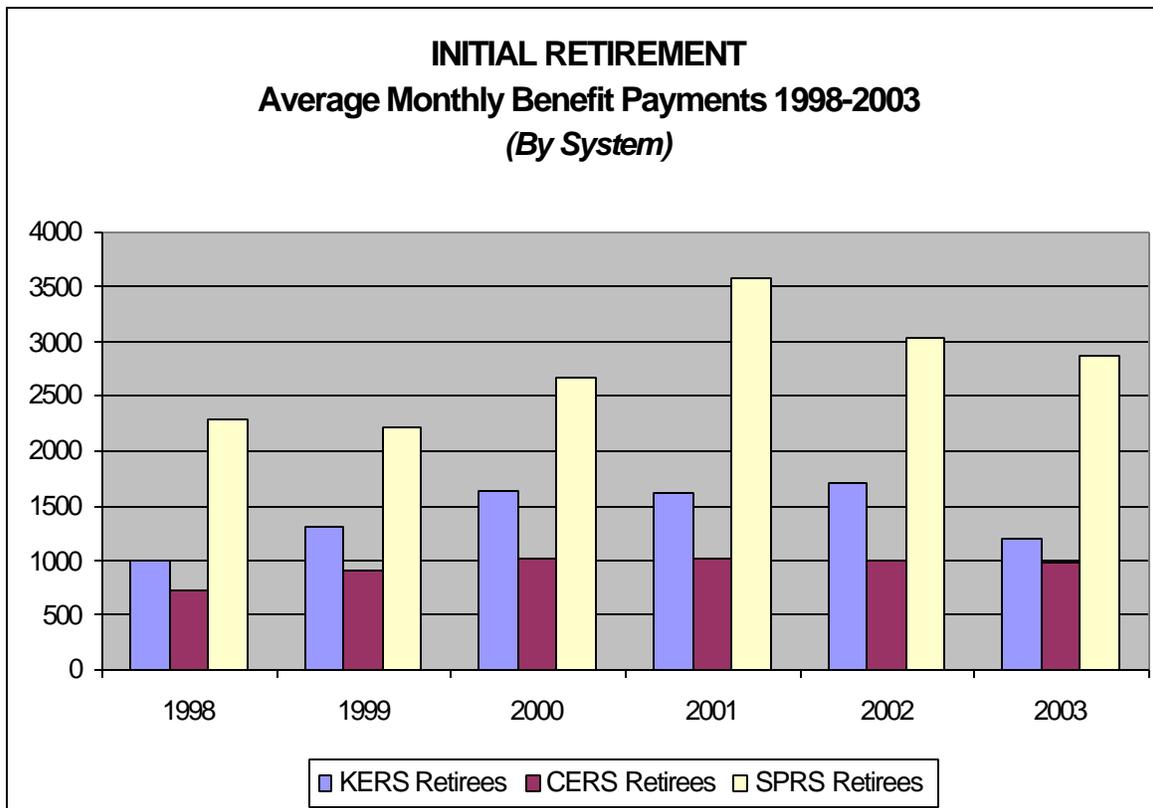
<b>STATE POLICE RETIREMENT SYSTEM</b>					
<b>Year Ending</b>	<b>Benefit Payments</b>	<b>Administrative Expenses</b>	<b>Refunds</b>	<b>Medical Insurance Expenses</b>	<b>Total</b>
<b>June 30, 1998</b>	\$17,735	\$47	\$70	\$2,611	\$20,463
<b>June 30, 1999</b>	\$19,136	\$68	\$44	\$2,754	\$22,002
<b>June 30, 2000</b>	\$19,974	\$82	\$80	\$3,028	\$23,164
<b>June 30, 2001</b>	\$22,644	\$92	\$80	\$3,575	\$26,391
<b>June 30, 2002</b>	\$24,839	\$105	\$25	\$4,049	\$29,018
<b>June 30, 2003</b>	\$27,862	\$86	\$97	\$4,550	\$32,595

*Kentucky Retirement Systems*

# ANALYSIS OF INITIAL RETIREMENT

1998-2003

	1998	1999	2000	2001	2002	2003
<b>KERS Retirees</b>	1,093	1,648	2,323	2,083	2,457	2,565
<b>Average Monthly Benefit</b>	\$1,000	\$1,296	\$1,639	\$1,616	\$1,709	\$1,203
<b>CERS Retirees</b>	1,626	2,349	2,485	2,265	2,733	3,115
<b>Average Monthly Benefit</b>	\$709	\$907	\$1,012	\$1,006	\$982	\$967
<b>SPRS Retirees</b>	46	23	42	53	58	53
<b>Average Monthly Benefit</b>	\$2,299	\$2,223	\$2,664	\$3,582	\$3,030	\$2,867



## Schedule of Benefit Expenses by Type

### KENTUCKY EMPLOYEES RETIREMENT SYSTEM

	NORMAL	EARLY	DISABILITY	DEATH	TOTAL
<b>FY 1997-98</b>					
Average Benefit	\$589	\$859	\$629	\$647	\$760
Retirees	4,248	11,920	1,772		17,940
Beneficiaries	827	890	636	782	3,135
Total Recipients	5,075	12,810	2,408	782	21,075
Monthly Benefits	\$2,989,698	\$11,006,325	\$1,512,760	\$505,747	\$16,014,530
<b>% of Total Monthly Benefits</b>	<b>19%</b>	<b>69%</b>	<b>9%</b>	<b>3%</b>	<b>100%</b>
<b>FY 1998-99</b>					
Average Benefit	\$630	\$944	\$662	\$686	\$830
Retirees	4,267	12,755	1,848		18,870
Beneficiaries	807	936	670	866	3,279
Total Recipients	5,074	13,691	2,518	866	22,149
Monthly Benefits	\$3,194,856	\$12,927,270	\$1,665,838	\$594,363	\$18,382,327
<b>% of Total Monthly Benefits</b>	<b>17%</b>	<b>70%</b>	<b>9%</b>	<b>4%</b>	<b>100%</b>
<b>FY 1999-00</b>					
Average Benefit	\$663	\$1,042	\$675	\$698	\$907
Retirees	4,360	14,323	1,977		20,660
Beneficiaries	804	978	689	885	3,356
Total Recipients	5,164	15,301	2,666	885	24,016
Monthly Benefits	\$3,425,223	\$15,949,488	\$1,799,238	\$618,038	\$21,791,987
<b>% of Total Monthly Benefits</b>	<b>16%</b>	<b>73%</b>	<b>8%</b>	<b>3%</b>	<b>100%</b>
<b>FY 2000-01</b>					
Average Benefit	\$706	\$1,135	\$702	\$726	\$987
Retirees	4,348	15,624	2,068		22,040
Beneficiaries	795	1,015	702	887	3,399
Total Recipients	5,143	16,639	2,770	887	25,439
Monthly Benefits	\$3,631,318	\$18,878,492	\$1,944,415	\$643,874	\$25,098,099
<b>% of Total Monthly Benefits</b>	<b>14%</b>	<b>75%</b>	<b>8%</b>	<b>3%</b>	<b>100%</b>
<b>FY 2001-02</b>					
Average Benefit	\$763	\$1,283	\$737	\$778	\$1,111
Retirees	4,341	17,193	2,104		23,657
Beneficiaries	796	1,039	696	863	3,394
Total Recipients	5,137	18,232	2,800	863	27,051
Monthly Benefits	\$3,921,539	\$23,392,161	\$2,063,497	\$685,848	\$30,063,045
<b>% of Total Monthly Benefits</b>	<b>13%</b>	<b>78%</b>	<b>7%</b>	<b>2%</b>	<b>100%</b>
<b>FY 2002-03</b>					
Average Benefit	\$1,054	\$452	\$931	\$1,191	\$1,297
Retirees	370	1,882	87		2,339
Beneficiaries	19	59	2	91	171
Total Recipients	389	1,941	89	91	2,510
Monthly Benefits	\$1,750,796	\$6,225,808	\$424,089	\$372,859	\$8,773,553
<b>% of Total Monthly Benefits</b>	<b>20%</b>	<b>71%</b>	<b>5%</b>	<b>4%</b>	<b>100%</b>

The information in the above tables includes only individuals receiving a monthly benefit as of June 30 in the indicated fiscal year. Retired reemployed members and individuals deceased prior to June are not included. As a result, the information for the current year will differ from that shown in the Retired Lives Summary in the Actuarial Section. See the Retired Lives Summary and Beneficiary Summary in the Actuarial Section for a further delineation of retirement options by system.

## Schedule of Benefit Expenses by Type

### COUNTY EMPLOYEES RETIREMENT SYSTEM

	NORMAL	EARLY	DISABILITY	DEATH	TOTAL
<b>FY 1997-98</b>					
Average Benefit	\$429	\$650	\$585	\$473	\$576
Retirees	5,095	11,238	2,165		18,498
Beneficiaries	594	544	416	614	2,168
Total Recipients	5,689	11,782	2,581	614	20,666
Monthly Benefits	\$2,438,180	\$7,660,693	\$1,511,141	\$290,517	\$11,900,531
<b>% of Total Monthly Benefits</b>	<b>20%</b>	<b>64%</b>	<b>13%</b>	<b>3%</b>	<b>100%</b>
<b>FY 1998-99</b>					
Average Benefit	\$466	\$718	\$604	\$482	\$630
Retirees	5,365	12,609	2,350		20,324
Beneficiaries	603	578	636	727	2,544
Total Recipients	5,968	13,187	2,986	727	22,868
Monthly Benefits	\$2,783,194	\$9,472,665	\$1,802,978	\$350,404	\$14,409,241
<b>% of Total Monthly Benefits</b>	<b>19%</b>	<b>66%</b>	<b>13%</b>	<b>2%</b>	<b>100%</b>
<b>FY 1999-00</b>					
Average Benefit	\$478	\$766	\$612	\$483	\$666
Retirees	5,628	14,179	2,633		22,440
Beneficiaries	620	609	639	771	2,639
Total Recipients	6,248	14,788	3,272	771	25,079
Monthly Benefits	\$2,985,474	\$11,328,818	\$2,003,432	\$372,601	\$16,690,325
<b>% of Total Monthly Benefits</b>	<b>18%</b>	<b>68%</b>	<b>12%</b>	<b>2%</b>	<b>100%</b>
<b>FY 2000-01</b>					
Average Benefit	\$499	\$816	\$638	\$503	\$708
Retirees	5,840	15,516	2,846		24,202
Beneficiaries	632	649	673	773	2,727
Total Recipients	6,472	16,165	3,519	773	26,929
Monthly Benefits	\$3,231,715	\$13,192,315	\$2,243,451	\$388,758	\$19,056,239
<b>% of Total Monthly Benefits</b>	<b>17%</b>	<b>69%</b>	<b>12%</b>	<b>2%</b>	<b>100%</b>
<b>FY 2001-02</b>					
Average Benefit	\$532	\$880	\$667	\$532	\$762
Retirees	6,025	16,999	3,132		26,156
Beneficiaries	664	695	531	801	2,691
Total Recipients	6,689	17,694	3,663	801	28,847
Monthly Benefits	\$3,555,481	\$15,563,130	\$2,441,911	\$426,386	\$21,986,908
<b>% of Total Monthly Benefits</b>	<b>16%</b>	<b>71%</b>	<b>11%</b>	<b>2%</b>	<b>100%</b>
<b>FY 2002-03</b>					
Average Benefit	\$659	\$1,156	\$765	\$466	\$1,514
Retirees	766	1,849	157	171	2,943
Beneficiaries	15	44	5	0	64
Total Recipients	781	1,893	162	171	3,007
Monthly Benefits	\$2,433,274	\$5,035,337	\$607,839	\$525,564	\$8,602,015
<b>% of Total Monthly Benefits</b>	<b>28%</b>	<b>59%</b>	<b>7%</b>	<b>6%</b>	<b>100%</b>

The information in the above tables includes only individuals receiving a monthly benefit as of June 30 in the indicated fiscal year. Retired reemployed members and individuals deceased prior to June are not included. As a result, the information for the current year will differ from that shown in the Retired Lives Summary in the Actuarial Section. See the Retired Lives Summary and Beneficiary Summary in the Actuarial Section for a further delineation of retirement options by system.

## Schedule of Benefit Expenses by Type

### STATE POLICE RETIREMENT SYSTEM

	NORMAL	EARLY	DISABILITY	DEATH	TOTAL
<b>FY 1997-98</b>					
Average Benefit	\$2,472	\$2,131	\$1,319	\$1,309	\$2,120
Retirees	101	520	33		654
Beneficiaries	20	4	7	20	51
Total Recipients	121	524	40	20	705
Monthly Benefits	\$299,059	\$1,116,767	\$52,744	\$26,178	\$1,494,748
<b>% of Total Monthly Benefits</b>	<b>20%</b>	<b>75%</b>	<b>4%</b>	<b>1%</b>	<b>100%</b>
<b>FY 1998-99</b>					
Average Benefit	\$2,495	\$2,175	\$1,024	\$1,237	\$2,102
Retirees	98	550	38		686
Beneficiaries	23	5	23	25	76
Total Recipients	121	555	61	25	762
Monthly Benefits	\$301,845	\$1,206,862	\$62,478	\$30,922	\$1,602,087
<b>% of Total Monthly Benefits</b>	<b>19%</b>	<b>75%</b>	<b>4%</b>	<b>2%</b>	<b>100%</b>
<b>FY 1999-00</b>					
Average Benefit	\$2,522	\$2,185	\$1,062	\$1,318	\$2,126
Retirees	98	585	40		723
Beneficiaries	25	5	21	23	74
Total Recipients	123	590	61	23	797
Monthly Benefits	\$310,242	\$1,289,260	\$64,788	\$30,323	\$1,694,613
<b>% of Total Monthly Benefits</b>	<b>18%</b>	<b>76%</b>	<b>4%</b>	<b>2%</b>	<b>100%</b>
<b>FY 2000-01</b>					
Average Benefit	\$2,677	\$2,305	\$1,107	\$1,354	\$2,258
Retirees	99	632	36		767
Beneficiaries	27	6	18	23	74
Total Recipients	126	638	54	23	841
Monthly Benefits	\$337,279	\$1,470,596	\$59,799	\$31,132	\$1,898,806
<b>% of Total Monthly Benefits</b>	<b>18%</b>	<b>77%</b>	<b>3%</b>	<b>2%</b>	<b>100%</b>
<b>FY 2001-02</b>					
Average Benefit	\$2,851	\$2,424	\$1,133	\$1,450	\$2,385
Retirees	105	682	26		813
Beneficiaries	26	7	28	22	83
Total Recipients	131	689	54	22	896
Monthly Benefits	\$373,474	\$1,670,425	\$61,170	\$31,894	\$2,136,963
<b>% of Total Monthly Benefits</b>	<b>17.5%</b>	<b>78%</b>	<b>3%</b>	<b>1.5%</b>	<b>100%</b>
<b>FY 2002-03</b>					
Average Benefit	\$3,116	\$3,509	\$1,705	0	\$3,358
Retirees	10	38	2		50
Beneficiaries	0	0	0	0	0
Total Recipients	10	38	2	0	50
Monthly Benefits	\$31,160	\$133,351	\$3,411	0	\$167,922
<b>% of Total Monthly Benefits</b>	<b>19%</b>	<b>79%</b>	<b>2%</b>	<b>0%</b>	<b>100%</b>

The information in the above tables includes only individuals receiving a monthly benefit as of June 30 in the indicated fiscal year. Retired reemployed members and individuals deceased prior to June are not included. As a result, the information for the current year will differ from that shown in the Retired Lives Summary in the Actuarial Section. See the Retired Lives Summary and Beneficiary Summary in the Actuarial Section for a further delineation of retirement options by system.

**Kentucky Retirement Systems****COMPARISON OF AVERAGE MONTHLY BENEFITS  
BY LENGTH OF SERVICE****KENTUCKY EMPLOYEES RETIREMENT SYSTEM**

<b>Service in Years</b>	<b>Under 2</b>	<b>2-5</b>	<b>6-10</b>	<b>11-15</b>	<b>16-20</b>	<b>21-25</b>	<b>26-30</b>	<b>31-35</b>	<b>Over 35</b>
Number of Recipients	1,022	1,070	3,725	3,910	3,571	3,810	6,014	3,855	1,638
Average Monthly Pay	89	181	283	471	705	994	73	2,426	3,279

**COUNTY EMPLOYEES RETIREMENT SYSTEM**

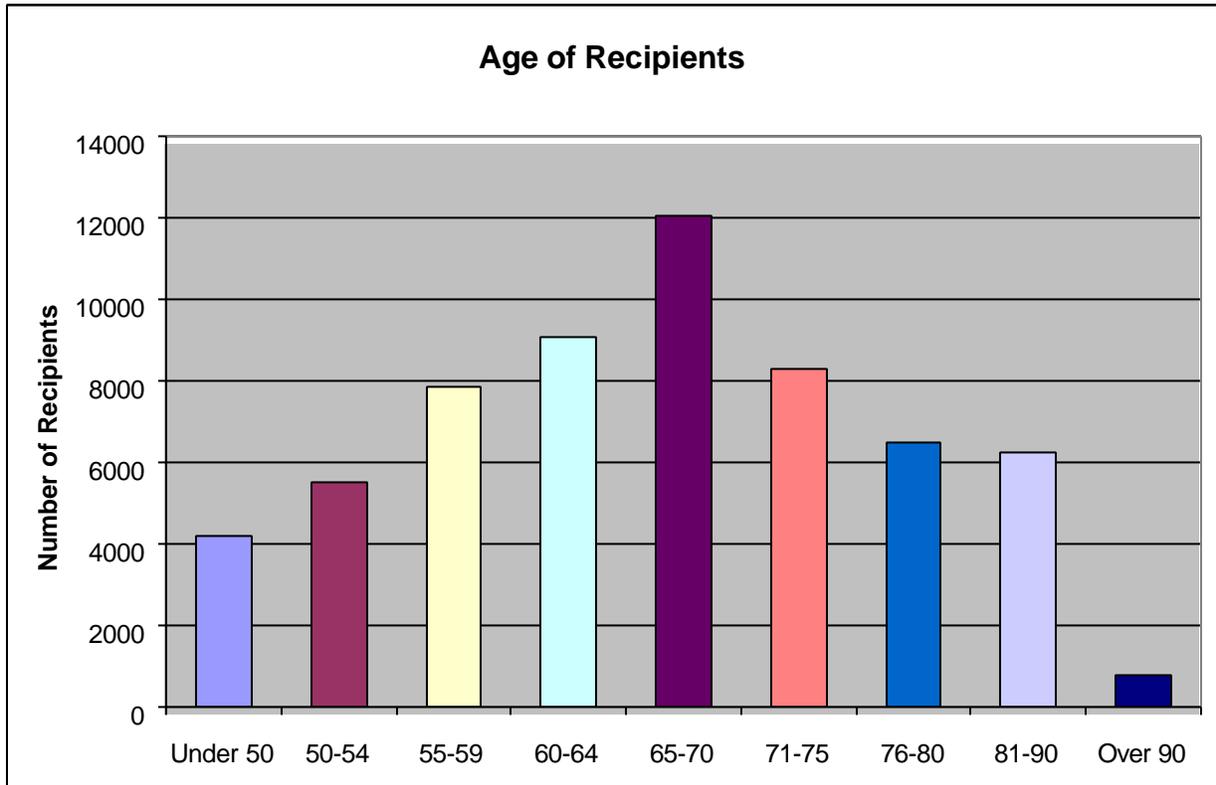
<b>Service in Years</b>	<b>Under 2</b>	<b>2-5</b>	<b>6-10</b>	<b>11-15</b>	<b>16-20</b>	<b>21-25</b>	<b>26-30</b>	<b>31-35</b>	<b>Over 35</b>
Number of Recipients	1,217	1,484	6,170	6,011	4,563	4,934	4,599	1,404	479
Average Monthly Pay	152	156	233	417	645	1,059	1,725	2,284	2,674

**STATE POLICE RETIREMENT SYSTEM**

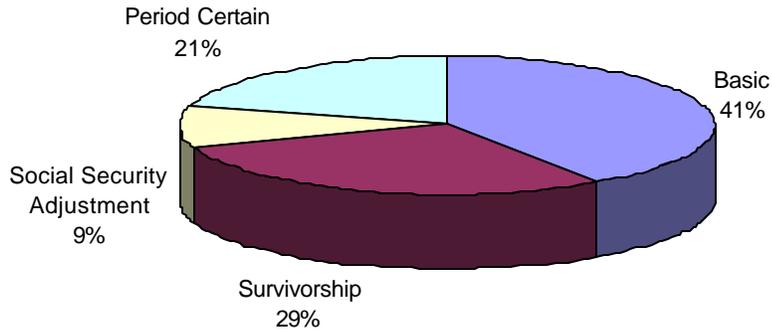
<b>Service in Years</b>	<b>Under 2</b>	<b>2-5</b>	<b>6-10</b>	<b>11-15</b>	<b>16-20</b>	<b>21-25</b>	<b>26-30</b>	<b>31-35</b>	<b>Over 35</b>
Number of Recipients	39	28	26	26	65	242	303	160	52
Average Monthly Pay	583	345	672	967	1,551	2,045	2,812	3,741	4,298

# AGE OF RECIPIENTS

(All Systems Combined)

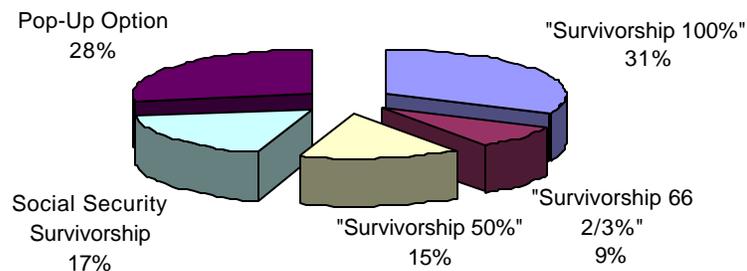


## Payment Options By Type (All Systems)



The Basic option is a single life annuity. Survivorship options include 100%, 66 2/3%, 50% and Pop-Up, which is a 100% survivorship option that increases to the Basic amount if the beneficiary dies or divorces the member prior to the member's death. Social Security Adjustment options provide enhanced benefits prior to age 62 and a reduced benefit after age 62. There are two Social Security Adjustment options: one with 100% survivorship and one with no survivor benefit.

## Survivorship Options By Type (All Systems)



**Kentucky Retirement Systems**

**TOTAL FISCAL YEAR RETIREMENT PAYMENTS  
BY COUNTY**

<b>Jefferson</b>	\$128,495,663	<b>Carter</b>	\$ 3,843,762	<b>Estill</b>	\$ 1,872,485
<b>Franklin</b>	93,102,485	<b>Harlan</b>	3,671,009	<b>Wolfe</b>	1,839,805
<b>Fayette</b>	41,099,046	<b>Bourbon</b>	3,422,366	<b>Washington</b>	1,828,793
<b>Warren</b>	17,842,914	<b>Grayson</b>	3,372,367	<b>Powell</b>	1,786,209
<b>Shelby</b>	16,510,638	<b>Knott</b>	3,345,583	<b>Carroll</b>	1,746,757
<b>Daviess</b>	15,901,761	<b>Johnson</b>	3,313,985	<b>Livingston</b>	1,572,313
<b>Kenton</b>	14,525,550	<b>Clay</b>	3,246,735	<b>Union</b>	1,568,984
<b>Pulaski</b>	13,799,128	<b>Taylor</b>	2,986,032	<b>Webster</b>	1,563,615
<b>Christian</b>	12,439,317	<b>Logan</b>	2,985,191	<b>Butler</b>	1,485,476
<b>McCracken</b>	11,237,340	<b>Knox</b>	2,887,891	<b>Metcalfe</b>	1,483,166
<b>Madison</b>	11,234,096	<b>Caldwell</b>	2,881,108	<b>Lee</b>	1,480,249
<b>Hardin</b>	11,160,644	<b>Perry</b>	2,877,191	<b>Todd</b>	1,465,296
<b>Anderson</b>	10,095,424	<b>Breathitt</b>	2,873,224	<b>Lewis</b>	1,457,081
<b>Boone</b>	9,231,777	<b>Trigg</b>	2,836,504	<b>McCreary</b>	1,417,656
<b>Campbell</b>	8,790,331	<b>Morgan</b>	2,786,700	<b>McLean</b>	1,415,830
<b>Oldham</b>	8,598,690	<b>Adair</b>	2,758,999	<b>Trimble</b>	1,411,063
<b>Bullitt</b>	7,343,909	<b>Spencer</b>	2,682,659	<b>Jackson</b>	1,386,407
<b>Woodford</b>	7,027,404	<b>Greenup</b>	2,661,299	<b>Green</b>	1,323,664
<b>Boyd</b>	6,734,520	<b>Lincoln</b>	2,630,862	<b>Magoffin</b>	1,319,760
<b>Laurel</b>	6,434,011	<b>Montgomery</b>	2,619,290	<b>Leslie</b>	1,231,082
<b>Scott</b>	6,412,965	<b>Harrison</b>	2,592,930	<b>Lawrence</b>	1,206,243
<b>Pike</b>	6,368,071	<b>Fleming</b>	2,551,402	<b>Clinton</b>	1,146,975
<b>Boyle</b>	6,312,255	<b>Wayne</b>	2,549,730	<b>Ballard</b>	1,146,327
<b>Hopkins</b>	6,282,160	<b>Letcher</b>	2,527,575	<b>Menifee</b>	1,133,386
<b>Henderson</b>	6,006,129	<b>Russell</b>	2,523,178	<b>Nicholas</b>	1,076,449
<b>Calloway</b>	5,903,474	<b>Marion</b>	2,522,784	<b>Owsley</b>	1,065,595
<b>Barren</b>	5,599,840	<b>Breckinridge</b>	2,360,980	<b>Simpson</b>	1,021,103
<b>Whitley</b>	5,307,383	<b>Muhlenberg</b>	2,255,232	<b>Bracken</b>	990,194
<b>Jessamine</b>	5,203,307	<b>Meade</b>	2,211,201	<b>Cumberland</b>	983,520
<b>Floyd</b>	5,121,533	<b>Lyon</b>	2,158,485	<b>Fulton</b>	960,311
<b>Rowan</b>	5,098,717	<b>Larue</b>	2,150,680	<b>Edmonson</b>	953,391
<b>Nelson</b>	5,098,306	<b>Ohio</b>	2,087,645	<b>Monroe</b>	924,108
<b>Henry</b>	5,041,565	<b>Bath</b>	2,086,863	<b>Hancock</b>	888,624
<b>Graves</b>	4,942,349	<b>Casey</b>	2,059,960	<b>Carlisle</b>	859,180
<b>Marshall</b>	4,766,965	<b>Garrard</b>	2,059,546	<b>Martin</b>	832,610
<b>Owen</b>	4,573,246	<b>Mason</b>	2,005,086	<b>Crittenden</b>	817,556
<b>Mercer</b>	4,363,712	<b>Pendleton</b>	1,913,937	<b>Elliott</b>	772,934
<b>Clark</b>	4,089,438	<b>Rockcastle</b>	1,893,085	<b>Gallatin</b>	641,255
<b>Bell</b>	3,999,854	<b>Hart</b>	1,883,517	<b>Hickman</b>	517,954
<b>Grant</b>	3,987,055	<b>Allen</b>	1,875,772	<b>Robertson</b>	298,779

Payments to Recipients Living in Other States  
\$33,458,337

TOTAL PAYMENTS TO MEMBERS AND BENEFICIARIES FOR FY 2002-03  
\$709,927,499

KENTUCKY RETIREMENT SYSTEMS

# **Compliance Section**

*Comprehensive Annual Financial Report*  
June 30, 2003



**REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL  
REPORTING BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED  
IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

Board of Trustees  
Kentucky Retirement Systems  
Frankfort, Kentucky

We have audited the financial statements of Kentucky Retirement Systems, a component unit of the Commonwealth of Kentucky, as of and for the year ended June 30, 2003, and have issued our report thereon dated September 18, 2003. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether Kentucky Retirement Systems' financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under Government Auditing Standards.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Kentucky Retirement Systems' internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses. However, we noted other matters involving the internal control over financial reporting that we have reported to the management of Kentucky Retirement Systems in a separate letter dated September 18, 2003.

This report is intended for the information of the audit committee, management, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

September 18, 2003  
Louisville, Kentucky

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